Supreme Court Rejects the Presumption of Prudence in Employer "Stock Drop" Claims Under ERISA

Labor & Employment Law Update

By Kelly Haab-Tallitsch on August 22, 2014

In *Fifth Third Bancorp v. Dudenhoeffer, No. 12-751 (June 25, 2014)*, the Supreme Court overhauled the legal landscape of ERISA "stock drop" litigation. The case was brought by 401(k) plan participants after Fifth Third's employer matching contributions, made in company stock to an ESOP component of the plan, dropped 74% over a two-year period. Plaintiffs argued that plan fiduciaries breached their duties under ERISA by investing in and maintaining investments in Fifth Third stock in light of the risks associated with the employer's subprime lending practices.

In a substantial departure from the presumption widely accepted by appellate courts, the Supreme Court held that ESOP fiduciaries are not entitled to a special "presumption of prudence" in lawsuits challenging their decision to invest plan assets in company stock. Instead, ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general, minus the diversification requirements.

ERISA imposes a "prudent person" standard of care on retirement plan fiduciaries, and courts prior to *Dudenhoeffer* applied that standard using a presumption that an ESOP fiduciaries' decision to remain invested in employer stock was reasonable. But the Court rejected the argument that an ESOP's explicit requirement to invest primarily in company stock should trump the duty of prudence, ruling that ESOP fiduciaries should be held to the same standards as other retirement plan fiduciaries. Thus, the Court made clear that ESOP fiduciaries must be vigilant in making investment decisions, and do not have a free pass to invest in company stock when doing so is not prudent.

However, the Court also recognized the importance of weeding out "meritless claims" and rejected the plaintiffs' arguments that the fiduciaries should have recognized the market was overvaluing the employer stock and should have acted on any inside information they possessed. The Court held that fiduciaries need not second-guess whether the market price of a publicly traded stock accurately reflects its value, nor do they have an obligation to trade based on material insider information.

The Supreme Court's ruling could result in an uptick in ERISA stock drop suits initially, but the high pleading standards set forth by the Court make it more difficult for plaintiffs to survive a motion to dismiss. Thus, on balance, *Dudenhoeffer* is unlikely to create significant additional liability for employers.