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CLIENT ALERT

Supreme Court Rewrites the Rules Governing ERISA Fiduciary Duty Claims Against ESOP Trustees

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The last week of the Supreme Court's Term included an important ruling affecting ERISA fiduciary breach litigation. On June 25, the Court issued its much-anticipated decision in *Fifth Third Bancorp et al. v. Dudenhoeffer*. The Court held that a fiduciary of an employee stock ownership plan is not exempt from ERISA's fiduciary duty rules in making decisions as to whether company-issued stock is an appropriate plan investment. Rulings announced since the Supreme Court's decision confirm that *Dudenhoeffer* is likely to trigger an increase in ERISA "company stock drop" litigation.

The Supreme Court's Ruling

The plaintiffs in *Dudenhoeffer* were participants in the Fifth Third Bancorp employee stock ownership plan (ESOP). They filed suit in July 2009, following a 74 percent drop in the price of the bank's stock. The decline was due to the bank's substantial exposure to sub-prime mortgage loans that were negatively impacted by the 2008 financial crisis. Like many "stock drop" claims, plaintiffs alleged that, as early as July 2007, the ESOP fiduciaries knew or should have known that Fifth Third's stock was overvalued and an inappropriate investment for plan participants. The district court applied a presumption of prudence, as recognized in cases such as *Moench v. Robertson,* 62 F.3d 553 (3d Cir. 1995), and granted Fifth Third's motion to dismiss the complaint for failure to state a claim. The Sixth Circuit reversed, holding that, although the presumption applied, it is evidentiary in nature and inapplicable at the pleading stage. The Sixth Circuit then concluded that the allegations in the complaint were sufficient to state a claim for a breach of fiduciary duty under ERISA.

The Supreme Court vacated and remanded the Sixth Circuit's decision. The Court held unanimously that there is no presumption of prudence applicable to ERISA fiduciary breach claims against ESOP fiduciaries. The Court looked to the statutory text of ERISA and noted that the only relief Congress provided to ESOP fiduciaries involves an exemption from ERISA's diversification requirements. The Court then concluded: "In our view, the law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings."

The Court's Views on Pleading Standards

The Court's opinion then observed that some of the arguments advanced by Fifth Third in favor of the *Moench* presumption nonetheless could be addressed in a motion to dismiss. Justice Breyer's opinion, in *dicta,* suggested two specific arguments available to fiduciaries, based on the pleading requirements articulated in *Ashcroft v. Iqbal* and *Bell Atlantic Corp. v. Twombly*.

First, the Court suggested that a fiduciary breach complaint based on publicly available information alone could face stiff opposition at the pleading stage. The Court observed that "where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over- or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances." The Court noted that ERISA fiduciaries, as with most other investors, have little hope of consistently outperforming the market based solely on an analysis of publicly available information. Accordingly, the Court opined that plan fiduciaries "may, as a general matter, . . . prudently rely on the market price" as the best estimate of the value of the company's share price. Notably, Justice Breyer's opinion for the Court provides no guidance as to what sort of allegations constitute "special circumstances" that would be sufficient to plead a violation of ERISA's fiduciary prudence standard.

Second, the Court expressed considerable concern about a fiduciary breach claim based on non-public information about the company's financial condition. Justice Breyer noted that ERISA's fiduciary duty of prudence does not require an ERISA fiduciary to break the law, including the insider trading and SEC disclosure laws. The Court observed that "[t]o state a claim for breach of the duty of prudence on the basis of inside information, a plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." The Court suggested that a complaint in such cases must plausibly allege that a prudent fiduciary in the defendant's position would not have concluded that stopping purchases of company stock or publicly disclosing negative information that would cause a drop in the stock price would do more harm than good to the account values of participants in the plan.

Early Reactions to the Decision

Two decisions issued since *Dudenhoeffer* provide additional guidance as to the appropriate pleading standards necessary for employer stock drop cases.

On July 15, the Fifth Circuit vacated a district court ruling in an ERISA stock drop case filed against BP following the explosion of the Deepwater Horizon oil rig in the Gulf of Mexico. *See Whitley et al. v. BP PLC et al.,* No. 12-20670 (5th Cir., July 15, 2014). The Court's short *per curiam* opinion contained little analysis and simply directed the district court to reconsider its decision in light of *Dudenhoeffer.*

In *Whitley,* the district court applied the *Moensch* presumption in granting BP's motion to dismiss. In concluding that plaintiffs had not set forth a viable claim, the court noted that they had referred to no evidence that the plan administrators had access to non-public information that could have alerted them to the fact that the risk of an explosion and spill at the Deepwater Horizon drilling platform was imminent. The district court also concluded that the risk of an oil spill and its resulting effect on BP's stock price wasn't a "novel risk" that was unknown to the participants who decided to invest their funds in the BP stock funds, as evidenced by a litany of spill and explosion incidents at BP facilities that were detailed in the complaint. Subsequent proceedings in *Whitley* are worth watching, to see whether plaintiffs' counsel will be able to satisfy the pleading standards suggested by Justice Breyer in *Dudenhoeffer.*

On June 30, the Supreme Court cited *Dudenhoeffer* and vacated the Ninth Circuit's decision in a stock drop case pending against Amgen. *See Amgen Inc. v. Harris, No.* 13-88 (June 30, 2014) *vacating Harris et al. v. Amgen,* 717 F.3d 1042 (9th Cir. 2013). Amgen was sued by participants in its ESOP after a 30 percent decline in the stock price following adverse publicity about alleged safety concerns with new pharmaceutical products under development by the company. The Ninth Circuit reversed the district court, which had granted defendants' motion to dismiss the complaint, in part because of the presumption of prudence. The Ninth Circuit opinion reaffirmed prior circuit precedent in *Quan v. Compter Sci. Corp.,* 623 F.3d 870 (9th Cir. 2010) adopting the *Moench* presumption. But the court concluded that the Amgen defendants could not avail themselves of the presumption, principally because of the lack of language in the plan documents that explicitly encouraged the plan's fiduciaries to invest in company stock.

Like *Whitley,* subsequent developments in *Harris* should be monitored by plan sponsors. *Harris* presents an interesting question of whether the pleading standards suggested by Justice Breyer can be satisfied in a case alleging that ERISA fiduciaries should have acted on non-public information. The existence of parallel securities law litigation against Amgen will likely inform the lower courts' interpretation of this issue. And *Harris* presents the recurring question, not addressed by the Court in *Dudenhoeffer,* of the relevance of plan language that either requires or encourages plan fiduciaries to offer company stock as an investment option. Notwithstanding the demise of the *Moench* presumption, such language is often important in fiduciary breach litigation because of the ERISA mandate requiring fiduciaries to follow the terms of the plan.

Implications for Plan Sponsors

The Court's conclusion invalidating the *Moensch* presumption in company stock-drop cases is an obvious blow to employer plan sponsors, as it removes the strongest and most common defense in many stock drop actions. Yet the Court's opinion is not entirely good news for the ERISA plaintiffs' bar. Justice Breyer's discussion of how *Iqbal* and *Twombly* can be applied in stock-drop cases will provide many employers with substantial arguments to seek early dismissal of many stock drop complaints. The vast majority of complaints filed in stock-drop cases to date make broad allegations that the fiduciaries "knew or should have known" the company's stock was an imprudent investment, based on publicly available information. The Court's suggestion that a "special circumstances" pleading obligation applies in such cases, if applied by lower courts, will make it considerably more difficult for plaintiffs making such claims to survive a motion to dismiss.

Plaintiffs should have an even harder row to hoe in drafting legally sufficient complaints based on non-public information possessed by the plan's fiduciaries. The Court's endorsement of the view that ERISA fiduciaries should not be required to violate the insider trading rules is welcome news for employer plan sponsors. Justice Breyer's suggestion that plaintiffs in such cases must plead that a prudent fiduciary would not have decided that it would do more harm than good to take action based on insider information is particularly rigorous. This standard would effectively require plaintiffs' counsel to "prove a negative" in order to survive a motion to dismiss based on defendant's possession of insider information.

The Court's opinion is nonetheless likely to spawn additional litigation in various types of stock drop cases. As illustrated by *Whitley v. BP* and *Harris v. Amgen,* lower courts will be asked to take another look at existing decisions rejecting stock drop cases that were based on the presumption of prudence. Fiduciaries of ESOPs holding non-publicly traded stock may be particularly impacted by the Court's rejection of the *Moench* presumption. The viability of future stock drop cases brought against public companies will almost certainly depend on the extent to which lower courts are receptive to the Court's suggestions about pleading standards.

For more information about this decision, or for assistance in evaluating your plan's approach to making investment decisions, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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Thomas P. Gies
Partner – Washington, D.C.

Phone: +1.202.624.2690
Email: tgies@crowell.com