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Fifth Third Bancorp v. Dudenhoeffer – An Analysis of the U.S. Supreme Court's Decision

June 26, 2014

For over two decades, federal courts have embraced the so-called Moench presumption of prudence in ERISA stock-drop cases. Pursuant to that presumption, courts have routinely dismissed such claims absent allegations in a complaint that a company's situation was dire, or that the company was on the brink of collapse. On June 25,2014, the U.S. Supreme Court issued its decision in the highly anticipated case, Fifth Third Bancorp v. Dudenhoeffer, wherein it concluded by unanimous decision that the presumption of prudence could not be supported by the text of ERISA. As discussed below, that may be at most only mixed victory for the plaintiffs' bar.

Factual Background

Participants in Fifth Third Bancorp's (Fifth Third's) defined contribution retirement plan (Plan) brought a putative class action against the Plan's fiduciary committee, among others, alleging that defendants breached their fiduciary duties in violation of ERISA.

Under the Plan, participants made contributions into an individual account and directed the Plan to invest those contributions in a menu of options pre-selected by Fifth Third. Of the twenty options available to participants during the relevant period, one was the Fifth Third stock fund, which had been designated an employee stock ownership plan (ESOP). Fifth Third matched the first 4% of a participant's contributions with company stock, after which participants could move such contributions to any other investment option.

Plaintiffs' complaint alleged that Fifth Third shifted from a conservative to a subprime lender and, consequently, Fifth Third's loan portfolio became increasingly exposed to defaults. It further alleged that Fifth Third either failed to disclose the resulting damage to the company and its stock or provided misleading disclosures. During the relevant period, Fifth Third's stock price declined 74%, resulting in the ESOP losing tens of millions of dollars.

Plaintiffs commenced a putative class action lawsuit, alleging, among other things, that defendants breached their fiduciary duties under ERISA by: (i) imprudently maintaining significant investment in Fifth Third stock and continuing to offer it as an authorized investment option; and (ii) by failing to provide Plan participants with accurate and complete information about Fifth Third and the risks of investment in Fifth Third stock.

The District Court's Decision

The district court granted defendants' motion to dismiss. *Dudenhoeffer v. Fifth Third Bancorp*, 757 F. Supp. 2d 753 (S.D. Ohio 2010). In so ruling, the district court first held that the determination as to whether the Fifth Third stock fund was an ESOP is a question of law appropriate for consideration on a motion to dismiss and concluded that it was, in fact, an ESOP. Second, the district court held that applying the *Moench* presumption is appropriate on a motion to dismiss, reasoning that a fiduciary breach claim involving an ESOP is plausible only if plaintiffs pled facts sufficient to overcome the presumption. Third, the district court found that plaintiffs' complaint failed to allege sufficient facts to overcome the presumption of prudence. As to the last point, the district court observed that Fifth Third's viability was never in serious doubt, and other large institutional investors actually increased their holdings in Fifth Third stock during the relevant period.

The district court also rejected plaintiffs' disclosure claims, finding that defendants' incorporation of securities filings (which allegedly contained misstatements and/or omissions regarding Fifth Third's financial condition) into the Plan's summary plan description were not made in a fiduciary capacity.

The Sixth Circuit's Opinion

The Sixth Circuit reversed. *Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410 (6th Cir. 2012). It concluded that a fiduciary's decision to invest in employer securities enjoys a presumption of prudence, but a plaintiff can rebut that presumption by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision. It further concluded that the presumption is not an additional pleading requirement and consequently does not apply at the motion to dismiss stage. In so ruling, the Sixth Circuit stated that its precedent (unlike in other circuits) had not established a specific rebuttal standard. Rather, the Sixth Circuit's standard imposes upon a plaintiff the burden to prove, through a fully developed evidentiary record, that a prudent fiduciary facing similar circumstances would have acted differently. Accordingly, to survive a motion to dismiss, plaintiffs' complaint only need allege facts sufficient to show that a fiduciary committed a breach that caused the loss. The Sixth Circuit found that plaintiffs had adequately pled: (a) a breach—Fifth Third engaged in subprime lending, Defendants were aware of the risks caused by such lending, and that such risks made investment in Fifth Third stock imprudent; (b) harm—the stock's value dropped 74%; and (c) causation—an investigation would have led a reasonable fiduciary to make different investment decisions.

The Sixth Circuit also concluded that Fifth Third's incorporation of the securities filings into the SPD constituted a fiduciary act. The court reasoned that the SPD is a fiduciary communication required by ERISA and selecting the information to convey through the SPD is a fiduciary activity, regardless of whether the information is explicit or incorporated by reference.

Fifth Third's Petition for Certiorari

The Supreme Court granted Fifth Third's petition for certiorari to consider whether the Sixth Circuit erred by holding that plaintiffs were not required to plausibly allege in their complaint that ESOP fiduciaries abused their discretion by remaining invested in employer stock in order to rebut the presumption of prudence.

The Supreme Court, however, declined to address the disclosure claim, *i.e.*, whether the Sixth Circuit erred by holding that securities filings become actionable ERISA fiduciary communications when they are incorporated by reference into plan documents.

The Supreme Court's Decision

The Supreme Court held that there was nothing in ERISA that supported the imposition of a presumption of prudence for ESOPs, and that, with the exception of ERISA's diversification requirement, the same standard of prudence applies to ESOPs as to all other ERISA plans. In so ruling, the Court focused on ERISA's provision that an ESOP fiduciary is exempt from the diversification requirement and also from the duty of prudence, but "*only to the extent that it requires diversification*." 29 U.S.C. § 1104(a)(2) (emphasis added).

The Court rejected several arguments advanced by Fifth Third in favor of adopting the presumption of prudence. Among them were the arguments that: (i) ERISA's duty to act prudently is in relation to "an enterprise of like character and like aims," and thus should be adjusted here to take into account the aims of ESOPs; and (ii) Congress had stated it was "deeply concerned" that its goals of encouraging employee stock ownership could be rendered unattainable by rulings treating ESOPs as conventional retirement plans. The Court concluded that the responsibilities of an ESOP fiduciary must be directed toward the duty to provide benefits and defray expenses, and thus any non-pecuniary interests, such as Congress' strong encouragement of employee stock ownership, did not warrant an alteration of the fiduciary standard.

The Court also concluded that: (i) plan sponsors cannot reduce or waive the prudent man standard of care by requiring investment in the company stock fund; (ii) the presumption "is an ill-fitting means" to protect ESOP fiduciaries from conflicts with the legal prohibition on insider trading; and (iii) the presumption was not an appropriate way to weed out meritless lawsuits.

The Court ultimately determined that the weeding out of meritless claims can be better accomplished through careful scrutiny of a complaint's allegations, and instructed the Sixth Circuit on remand to apply the pleading standard set forth in *Twombly* and *Iqbal*. In conducting that evaluation, the Court stated that allegations that a fiduciary should have recognized from *publicly available information* that the market improperly valued the stock are "implausible as a general rule, at least in the absence of special circumstances" that would make reliance on the market's valuation imprudent.

To state a claim for breach of the duty of prudence on the basis of *inside information*, the Court stated that "a plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws andthat a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." The Court noted three points for the lower courts consider in this regard. First, the duty of prudence does not require a fiduciary to break the law. Second, courts should consider whether a plan fiduciary's decision to purchase (or refrain from purchasing) additional stock or for failing to disclose information to the public could conflict with the federal securities laws or with the objectives of those laws. Third, courts should consider whether a prudent fiduciary could not have concluded that stopping purchases or publicly disclosing negative information would do more harm than good to the stock fund.

View from Proskauer

Although the presumption of prudence in ERISA stock drop cases is no more, the Court has nevertheless imposed considerable burdens on plaintiffs. In the absence of insider information, it would appear that the opportunity to assert a viable claim will be limited, given the Court's requirement that the plaintiffs plead "special circumstances" that would support the conclusion that the price does not reflect the value of the stock.

The Court has also set forth substantial pleading requirements even in the case of claims based on nonpublic information, including that there was an alternative course of conduct (such as refraining from purchasing or providing information) that would have left the plan better off, and that was not inconsistent with the securities laws. It remains to be seen whether district courts will be prepared to evaluate allegations and theories proffered to sustain this burden at the motion to dismiss stage, but the Supreme Court has certainly suggested that they endeavor to do so.

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