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# Fifth Circuit Upholds Dismissal of Diversification and Prudence Claims Targeting A Single Stock Fund in a 401(k) Plan

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The Fifth Circuit in *Schweitzer v. Inv. Comm. of Phillips 66 Sav. Plan* dismissed claims against 401(k) plan fiduciaries related to allowing plan participants to hold a single stock that was not an employer security as a plan investment alternative. No. 18-cv-20379, 2020 WL 2611542 (5th Cir. May 22, 2020). The Court held that: (i) 401(k) plan fiduciaries had a duty to ensure that the plan's investment line-up was diversified, but no duty to ensure that participants actually diversified their portfolios; (ii) the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014), effectively foreclosed claims that the plan fiduciaries should have taken action on the basis of public information that suggested risk from holding the stock; and (iii) ERISA does not prohibit an individual account plan, like a 401(k) plan, from offering a single-stock fund.

As discussed below, the Court's decision offers meaningful guidance to fiduciaries of participant-directed plans and, more specifically, to those evaluating what to do with a company stock fund after a spinoff or divestiture.

Background

ConocoPhillips maintained a 401(k) plan with two employer stock funds that invested in ConocoPhillips stock. ConocoPhillips spun off certain operations to Phillips 66, which was not affiliated with ConocoPhillips. The spinoff resulted in the transfer of over 10,000 ConocoPhillips employees to Phillips 66, and their 401(k) accounts were transferred to a separate plan sponsored by Phillips 66.

Many of the transferred employees had invested in the ConocoPhillips stock funds. Those investments transferred in-kind to the Phillips 66 plan. As a result, the Phillips 66 Plan held two funds with a single stock that was not an employer security. The Phillips 66 plan's fiduciaries closed the funds to new investments, and participants were allowed to sell at any time, but those who did not want to sell were allowed to hold their investments in the funds. During the five-year period that followed the spinoff, ConocoPhillips's share price increased significantly and then decreased just as significantly.

Participants in the Phillips 66 Plan filed a putative class action complaint alleging two ERISA breach of fiduciary duty claims: breach of the duty of diversification by offering the ConocoPhillips stock funds; and breach of the duty of prudence for failing to remove the ConocoPhillips stock funds. The participants pointed to the inherent risk of investing in a single stock and publicly available "red flags" that purportedly signaled additional risk.

The district court dismissed the complaint for failure to state a claim. The district court first found that the diversification claim failed because participants could no longer invest in the ConocoPhillips stock funds and participants could remove their assets from the funds at any time. The district court concluded that the claim was really an issue of prudence and whether the plan fiduciaries should have forced participants to divest their holdings from the funds. The district court then evaluated the participants' breach of the duty of prudence claim and concluded that it was foreclosed by the Supreme Court's ruling in *Dudenhoeffer.*

The Fifth Circuit's Opinion

The Fifth Circuit affirmed the district court's dismissal of all claims. To begin with, the Court concluded that the diversification claim failed because the complaint lacked any allegation that the fiduciaries failed to offer a diverse menu of investment options or otherwise warn the participants of the risk of assembling a non-diversified portfolio. In so ruling, the Court rejected the participants' reliance on authority addressing diversification requirements for defined benefit plans. The court explained that, for a defined contribution plan, a fiduciary's responsibility is to create a diverse menu of available investment options. Individual options on the menu do not necessarily have to be diverse, and allocation of assets among the available options is the responsibility of each participant.

The Court next turned to the participants' claim that the fiduciaries breached the duty of prudence by allowing participants to hold their investments in the ConocoPhillips stock funds after the spinoff. First, the Court concluded that the Supreme Court's decision in *Dudenhoeffer* precluded plaintiffs' claim that the plan fiduciaries should have known from publicly available information that ConocoPhillips' share price did not adequately reflect the stock's risk.

Nevertheless, the Court noted that, under some circumstances, it could be imprudent to keep a single-stock fund on the investment menu. The Court determined that *Dudenhoeffer* did not control here because this was not a claim about whether the plan fiduciaries should have taken action based on publicly available information and did not involve employer securities. The Court concluded that the fiduciaries were not imprudent because they had closed the ConocoPhillips stock funds to new investments and adequately warned participants of the risks of not diversifying in the summary plan description.

Proskauer's Perspective

The Fifth Circuit's ruling approves a common approach for handling company stock funds after a spinoff or similar divestiture. Nevertheless, plan fiduciaries should continue to monitor all investment options, and to keep investment disclosures up to date, to ensure that participants have the information necessary to make sound investment decisions.

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