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U.S. Supreme Court Grants *Certiorari* in ERISA Stock Drop Case

By Paul Flum

On December 13, 2013, the U.S. Supreme Court granted *certiorari* in *Dudenhoeffer v. Fifth Third Bancorp*, et al., No. 12-751, to review a decision by the Sixth Circuit reversing dismissal of a complaint in an ERISA stock drop case. The Court granted *certiorari* on the following question:

> *Whether the Sixth Circuit erred by holding that Respondents were not required to plausibly allege in their complaint that the fiduciaries of an employee stock ownership plan ("ESOP") abused their discretion by remaining invested in employer stock, in order to overcome the presumption that their decision to invest in employer stock was reasonable, as required by the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1101, et seq. ("ERISA"), and every other circuit to address the issue.*

The case bears watching, since the Court's decision stands to resolve a split among the lower courts over whether a presumption of prudence protects fiduciaries of ERISA plans against suits challenging investments in employer stock—an important first line of defense in ERISA stock drop litigation.

DEVELOPMENT OF THE PRESUMPTION OF PRUDENCE

ERISA imposes a "prudent person" standard of care on plan fiduciaries. To comply with that standard, a fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

In applying that standard to cases involving investment in employer stock, courts have increasingly applied a deferential presumption of reasonableness (or presumption of prudence, as it is sometimes called). To rebut this presumption, a plaintiff must establish that the decision to allow such investment was an abuse of discretion. Courts have set forth various guidelines for how this standard may be met. In the Ninth Circuit, for example, a plaintiff must show that the company's viability was in jeopardy or was subject to serious mismanagement. In the Third Circuit, a plaintiff must show that the company faced a dire situation. The presumption of prudence is intended to strike a balance between ensuring responsible management of company retirement plans, on the one hand, and encouraging the adoption of plans that link employee compensation to the company's success, on the other. Until *Fifth Third Bancorp.*, all circuits to address the issue have concluded that the presumption of prudence applies at the pleading stage.

THE *FIFTH THIRD BANCORP* CASE

Consistent with the trend, in *Fifth Third Bancorp*, the district court granted defendants' motion to dismiss, reasoning that the complaint failed to allege facts, which if proven, could establish that it was imprudent to permit

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investment in company stock. In particular, the court held that allegations that the company had engaged in "improvident and even perhaps disastrous" lending practices, which in turn caused a "substantial decline in the price of its common stock," did not establish "the type of dire financial predicament" necessary to establish a claim for breach of fiduciary duty under ERISA.

The Sixth Circuit reversed, holding that the presumption of prudence does not apply at the pleading stage. The Sixth Circuit acknowledged that other circuits had reached the opposite conclusion but distinguished those cases on the ground that they set forth "narrowly defined" standards for rebutting the presumption. Applying the "normal rules of notice" under Rule 8, the Sixth Circuit held that the plaintiffs' prudence allegations were sufficient.

WHAT TO EXPECT FROM THE SUPREME COURT

Class action ERISA stock drop cases are often filed on the heels of shareholder securities class actions. As noted, the clear trend among the lower courts has been to subject these parallel ERISA suits to the presumption of prudence, and to dismiss complaints that fail to allege extraordinary circumstances threatening the company's financial viability. The Sixth Circuit's *Fifth Third Bancorp* decision is a notable exception to that trend. The Supreme Court can now be expected to provide guidance on the availability and parameters of this important defense. Regardless of the outcome, the case bears watching by officers, directors, and employees whose responsibilities may expose them to ERISA claims for breach of fiduciary duty in connection with employee investments in company stock.

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