Employee Benefits & Compensation Planning
ALERT
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Moench On This - Implications of the U.S. Supreme Court's Decision in *Fifth Third Bancorp v. Dudenhoeffer* for ESOP Fiduciaries

On June 25, 2014, in a unanimous decision, the U.S. Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, held that fiduciaries of employee stock ownership plans (ESOPs) are not protected by a presumption that they have acted prudently in making investment decisions—a presumption commonly referred to as the "presumption of prudence" or the "*Moench* presumption."

The presumption of prudence, as originally approved in 1995 by the Third Circuit Court of Appeals in the case of *Moench v. Robertson*, provided that ESOP fiduciaries are presumed to be acting prudently in holding or offering employer stock as plan investments unless there is reason to believe the company's survival is at risk or in doubt. The presumption had been adopted, in one form or another, by all of the circuit courts of appeal, and although some circuits had placed limits on it, no circuit court had specifically rejected it.

As a result of the Supreme Court ruling, except for the obligation to diversify investments, ESOP fiduciaries are subject to the same duty of prudence that applies to all ERISA fiduciaries. On the surface, this decision seems to be a major victory for plaintiffs filing lawsuits against ESOP fiduciaries; in reality, the decision may not have a significant impact on fiduciary investment decisions.

Key Facts

This case arose when former employees and participants in the Fifth Third Bancorp ESOP filed a lawsuit against Fifth Third and several of its officers (as fiduciaries of the ESOP) alleging that the fiduciaries breached their duty of prudence imposed by ERISA because: (1) they should have known, based both on publicly available and inside information, that Fifth Third stock was overpriced and excessively risky, and (2) a prudent fiduciary would have responded to this information by selling off the ESOP's Fifth Third stock holdings, refraining from purchasing more of the stock, or disclosing the negative inside information so that the market could correct the stock's price downward. According to the complaint, the fiduciaries failed to do these things, resulting in a decreased stock price and diminished retirement savings for the ESOP participants.

The district court dismissed the complaint, but the Sixth Circuit Court of Appeals reversed, concluding that ESOP fiduciaries are entitled to the presumption of prudence, though only at the evidentiary stage and not at the pleading stage. The Supreme Court held that ESOP fiduciaries are not entitled to any special presumption of prudence, but rather, are subject to the same duty of prudence that applies to ERISA fiduciaries in general. Further, the Supreme Court concluded that, on remand,

the Sixth Circuit Court of Appeals should reconsider whether the complaint states a valid claim and provided standards for this reconsideration.

Implications for ESOP Fiduciaries

While rejecting the presumption of prudence that for so long had shielded them from liability, the ruling provided significant reassurance for ESOP fiduciaries. Justice Stephen Breyer, writing for the Court, made it clear that: (1) when employer stock in an ESOP is publicly traded, allegations that a fiduciary should have recognized, based on generally available information, that the market is overvaluing or undervaluing the stock are generally implausible under current standards, and (2) to state a claim for breach of the duty of prudence, a complaint must identify alternative action that the fiduciary could have taken that would have been legal and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it. With respect to disclosure of insider information, Justice Breyer confirmed that a fiduciary never is required to break the law to satisfy the duty of prudence under ERISA.

Additionally, the Court acknowledged that Congress seeks to encourage the establishment of ESOPs, recognized that ESOPs should not be treated like conventional retirement plans and expressly preserved the exemption from the diversification requirement that allows ESOPs to invest primarily or exclusively in employer stock. Consequently, in our view, the decision will not significantly impair or diminish the ability of ESOP fiduciaries to make plan decisions and is unlikely to have any substantial impact on closely held ESOP companies.

If you have any questions regarding this Alert, please contact member of the Fox Rothschild's Employee Benefits & Compensation Planning Practice.

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