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Supreme Court Establishes New Standard for Fiduciaries of ESOP Plans

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The Supreme Court, in *Fifth Third Bancorp v. John Dudenhoeffer* (*Dudenhoeffer*), recently established new standards for determining when fiduciaries of Employee Stock Ownership Plans (ESOPs) act prudently regarding a company's stock in an ESOP. Specifically, the Court considered whether an ESOP fiduciary's decision to buy or hold stock or not sell stock, when challenged, is entitled to a "presumption of prudence." ERISA requires fiduciaries to act prudently and solely in the interest of a plan's participants and beneficiaries, and to diversify the plan's investments. With respect to ESOPs, **ERISA specifically provides that the diversification aspect of the prudence requirement is not violated by the purchase and holding of employer securities**. In connection with so-called "stock drop" cases ESOP plan participants, supported by the Department of Labor's amicus brief, argued that, except for the duty to diversify assets, the ERISA prudence rule applies to ESOPs, and that a plan fiduciary must continually monitor the employer stock to determine that it remains a prudent investment. Despite ERISA's express provision that an ESOP fiduciary does not violate the prudent requirement by not diversifying a plan's investments, the circuit courts of appeals that have considered this issue have gone beyond ERISA's express language and, for almost 20 years, held that ESOP fiduciaries enjoy a "presumption of prudence" regarding employer securities. In rejecting the "presumption of prudence" standard, the Court held:

… 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. Having rejected the "presumption of prudence" standard, the Court enunciated guidelines for the lower courts to consider when dealing with allegations of fiduciary breach in ESOP plans. First, the Court considered whether a fiduciary acts imprudently when relying on publicly available information in continuing to buy or hold employer securities. The Court held:

… a fiduciary usually is not imprudent to assume that a major stock market … provides the best

estimate of the value of the stocks traded on it that is available to him. The Court went on to state, however, that it was not considering whether a plaintiff could plausibly allege imprudence

on the basis of publicly available information by pointing to a special circumstance affecting the reliability of the market price as an unbiased assessment of the security's value in light of all public information. The Court then considered whether a fiduciary acts imprudently by failing to act on the basis of non-public (insider) information that was available to the fiduciary:

To 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. In determining when a fiduciary should act on insider information, the Court provided the following guidance:

1. ERISA does not require a fiduciary to break the law.
2. Courts should consider whether a fiduciary's decision to either refrain from making a trade on the basis of insider information or disclose insider information to the public conflicts with the insider trading and corporate disclosure requirements of the securities laws.
3. Courts should consider whether a fiduciary's action based on insider information would do more harm than good to the plan.

Although the decision involved an ESOP, it is much broader and also applies to all other ERISA covered retirement plans that offer company stock as an investment option under the plan. The decision will cause plan fiduciaries of plans with employer stock to increase their level of plan review and monitoring. In addition, given the uncertainty as to how lower courts will interpret the Court's decision, employers who do not currently offer company stock may be reluctant to begin offering that option. Additionally, employers that already offer company stock may decide to eliminate it as an investment option under their plans.

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