Supreme Court Overturns Moench Presumption in *Fifth Third Bancorp v. Dudenhoeffer*

Introduction

The U.S. Supreme Court on June 25, 2014, unanimously ruled that fiduciaries of Employee Stock Ownership Plans ("ESOPS") are not entitled to a "presumption of prudence," overturning the longstanding Moench presumption that had previously insulated ESOP fiduciaries from liability in stock drop cases. While we are pleased with the Court's decision to overrule the presumption, our satisfaction with the opinion is tempered by the fact that the Court arguably created a more stringent pleading standard for alleging a breach of the duty of prudence.

Facts and Background

In *Dudenhoeffer*, participants in Fifth Third Bank's ESOP alleged that the ESOP's fiduciaries breached their duty of prudence by continuing to purchase Fifth Third stock even though the fiduciaries knew, based on both public and inside information, that the stock was overvalued and that the economy was on the brink of collapse, as the subprime mortgage lending bubble was on the verge of bursting. Given this knowledge, the participants alleged that the ESOP's fiduciaries should have sold at least some of the ESOP's holdings in Fifth Third Bank. The fiduciaries failed to do so, instead continuing to purchase Fifth Third stock. Thus, when the market did eventually crash, Fifth Third's stock dropped precipitously, thereby eliminating much of the participants' retirement savings.

Relying on the Moench presumption, the United States District Court for the Southern District of Ohio dismissed the participants' complaint, holding that when a lawsuit challenges an ESOP fiduciary's investment decisions, "the plan fiduciaries start with a presumption that their decision to remain invested in employer securities was reasonable." The district court held that the presumption applied at the pleading stage, and the complaint's allegations were insufficient to rebut it.

The Court of Appeals for the Sixth Circuit reversed, holding that although ESOP fiduciaries are entitled to a presumption of prudence, the presumption is an evidentiary tool, not a pleading tool and did not apply when ruling on a motion to dismiss. Accordingly, the Sixth Circuit simply examined the allegations in the complaint and held that they were sufficient to state a claim for breach of the fiduciary duty of prudence.

Holding, Analysis, and Implications

The crucial holding in this case, and the one getting the most media attention, is the Court's decision to overturn the Moench presumption by holding that ESOP fiduciaries are not entitled to a presumption of prudence. Rather, they are subject to the same strict duty of prudence applicable to all fiduciary decision-making. The Court explained that while it recognized that the Employee Retirement Income Security Act

("ERISA") must strike a balance between participants' rights under a plan and fostering a regulatory environment that encourages employers to create and maintain plans, it did not believe that the presumption was "an appropriate way to weed out meritless lawsuits or to provide the requisite 'balancing'. . . .[because] such a rule does not readily divide the plausible sheep from the meritless goats." This holding is a victory for plan participants, who were previously stymied by the presumption when attempting to hold ESOP fiduciaries accountable for failing to sell company stock when the stock dropped.

This victory is tempered by the remainder of the opinion, however, which arguably made winning a motion to dismiss for breach of the duty of prudence more difficult. The Court explained that weeding out meritless claims is best accomplished "through careful, context-sensitive scrutiny of a complaint's allegations," and provided a roadmap of issues that lower courts should consider when ruling on a motion to dismiss. First, the Court explained that "where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over-or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances." The Court, however, failed to define what constitutes "special circumstances." Whether pleading such circumstances will impose a difficult burden on participants going forward will ultimately be determined by how lower courts interpret the phrase.

With regards to allegations that fiduciaries should have bought or sold stock based on nonpublic information, the Court was clear that the duty of prudence "cannot require an ESOP fiduciary to perform an action . . . that would violate the securities laws" and directed lower courts to consider the extent to which a fiduciary's decision to buy or sell based on inside information or to disclose inside information "could conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws." Finally, the Court noted that when reviewing such claims, lower courts should also "consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position could not have concluded that stopping purchases – which the market might take as a sign that insider fiduciaries view the employer's stock as a bad investment – or publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and concomitant drop in the value of the stock already held by the fund." In other words, participants' ability to demonstrate a breach of prudence for inside information claims is confined to circumstances where they can establish that a fiduciary's disclosure of inside information or decision to stop purchasing company stock would not violate the securities laws and would not cause more harm than good to the fund.

The implications of the Opinion will be forthcoming as lower courts interpret the Supreme Court's decision. We will continue to monitor the developments and provide updates as necessary.