Miller & Chevalier

Fifth Third Corp. v. Dudenhoeffer: What Did the Supreme Court Say and Really Mean?

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Last week the Supreme Court issued its opinion in *Fifth Third Bancorp v. Dudenhoeffer*, an important case involving the question of whether fiduciaries of "employee stock ownership plans" (ESOPs) are entitled to a "presumption of prudence" in evaluating their investment decisions related to company stock. While doing away with the presumption, the Court's opinion provided new, defense-friendly legal standards that can serve to guide all ERISA fiduciaries, resulting in a broader holding than court-watchers had originally anticipated from this case.

As presented in the briefs and at oral argument, the case appeared to be a narrow one - do ESOP fiduciaries enjoy a court-created "presumption of prudence" when their decisions to buy or hold company stock are challenged in court. Many lower courts had found such a presumption, based on an ERISA provision that relieves ESOP fiduciaries of the general obligation to diversify assets, and a general Congressional intent to encourage ESOP fiduciaries to buy and hold company stock in the their pension plan portfolios. On this narrow question, however, the Court determined that ERISA does not create such a presumption, and that ESOP fiduciaries should accordingly be held to the same standards as all ERISA fiduciaries in general, except that they need not diversify the fund's assets.

But the Court's opinion went on from there to discuss the general fiduciary obligations of all ERISA fiduciaries when their decisions are challenged in court, holding that the heightened standards that the Court has recently adopted in other civil contexts (known as "*Twombley/Iqbal* standards") apply to suits against ERISA fiduciaries as well. In this context, the *Twombley/Iqbal* standards require courts to "carefully assess" whether the complaint states a "plausible" claim that the defendant has acted imprudently. This is a meaningful standard, and one that the Court strongly suggested that the plaintiff could not meet in the *Dudenhoeffer* case. Two aspects of the Court's analysis are worth highlighting.

First, the Court assessed the plaintiffs' claim that the defendant fiduciaries should have known, from public reports, that holding on to, and purchasing, company stock was imprudent. The Court held that this claim could not meet the plausibility standard because "allegations that a fiduciary should have recognized from publically available information alone that the market was over- or undervaluing the stock are implausible as a general rule."

Second, the Court assessed the plaintiffs' claim that the defendants acted imprudently by failing to trade on insider information, known to them only through their position in the company. The Court held that in such lawsuits, 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 have viewed as more likely to harm the fund than to help it." As the Court then explained, the securities laws generally prohibit the trading on insider information so most claims that allege that the fiduciary should have done so are not plausible, as they would not be consistent with the securities laws. And, even in those cases where plaintiffs allege an alternative that would be consistent with the securities laws - *e.g.*, refraining from additional purchases or disclosing the information to the public - a reviewing court is required to examine such alternatives with an eye toward whether such actions would do more harm than good by devaluing what could be the largest asset in a plan's portfolio.

What does this new standard mean for ERISA fiduciaries? In a broad sense, by explicitly requiring plaintiffs in these suits to plausibly allege an alternative action that defendants could have undertaken consistent with the above standards, ERISA suits against fiduciaries should likely be subjected to much greater scrutiny at the pleadings stage. This should allow for earlier dismissals, and fewer suits that proceed through costly discovery. Moreover, it also provides some concrete guidance for fiduciaries. The most basic teaching of this case is that they should not be afraid to rely on the current market price of a stock as a fair assessment of its value. The court's opinion takes a dim view of the argument that the fiduciary should not accept the market value as the correct value of the underlying assets and suggests that cases proceeding under this theory normally should be immediately thrown out without discovery. Likewise, if an ERISA fiduciary has doubts about whether they should divest the plan of company stock based on "insider information," *Dudenhoeffer* provides a roadmap for a the fiduciary - evaluate (and document) whether you could take any action with respect to the ESOP consistent with securities laws, and if so, whether that action might actually cause more harm than benefit to the fund. Indeed, it is not hard to imagine courts creating a new presumption of prudence where a defendant can demonstrate that it undertook just such an evaluation.
