Fiduciary Considerations

The post-*Dudenhoeffer* era

NOW that the Supreme Court has overturned the Moench presumption in *Dudenhoeffer v. Fifth Third Bancorp*, it's a good time to examine what the case may mean for fiduciaries of 401(k) plans that offer employer stock as an investment option, as well as employee stock ownership plans (ESOPs).

In the past, many plans with employer stock investments have been subject to class-action lawsuits alleging a breach of fiduciary duty from holding and/or allowing further investment in employer stock after a precipitous decline in its value. A key defense for employers in these "stock-drop" cases was the so-called "Moench presumption" of prudence, named after the 1995 appellate court decision. This presumption meant that a plan fiduciary's decision to remain invested in employer stock was presumed to be reasonable. In *Dudenhoeffer*, the Supreme Court held that there is no such presumption.

At first glance, the high court's rejection of the Moench presumption may be viewed as unwelcome news for plan fiduciaries, as it eliminates a standard defense applied at the initial stage of litigation. Application of the presumption meant that many participants' claims were unable to survive a motion to dismiss, and the time and expense of discovery could be avoided. However, a closer examination of the Supreme Court's *Dudenhoeffer* decision reveals findings that should please retirement plan fiduciaries.

Pro-Fiduciary Aspects of *Dudenhoeffer*

One pro-fiduciary aspect of *Dudenhoeffer* is a new defense available to plan fiduciaries faced with stock-drop claims. According to the Supreme Court, fiduciaries evaluating an investment in employer stock may rely on its market price unless there are "special circumstances."

Specifically, the court held 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." This means that the stock market price is the best estimate of its value. However, the Supreme Court did not address what it meant by "special circumstances," and, as a result, lower courts will need to determine when a plan fiduciary should have considered the market price as questionable.

Another pro-fiduciary aspect of *Dudenhoeffer* is found in the court's discussion of the impact of insider trading rules on stock-drop cases. Stock-drop claims often allege that the fiduciaries were imprudent in failing to act on the inside information they possessed. Securities laws, however, prohibit the use of nonpublic information about the employer. This prohibition can conflict with a plan fiduciary's duties if the fiduciary is a company insider who has access to such information that could affect the value of the employer's stock. The court found that the Moench presumption was an "ill-fitting" means to address this conflict. Instead, the court instructs that, in order to state a claim that a fiduciary acted imprudently by failing to sell employer stock on the basis of nonpublic, 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."

The court further instructed lower courts faced with a claim of a fiduciary's imprudence that 1) the Employee Retirement Income Security Act (ERISA)'s duties do not require that a fiduciary violate insider trading laws; 2) requiring a sale or planned purchase of employer stock on the basis of inside information could conflict with insider trading laws, as could public disclosure of the information; and 3) a complaint must plausibly allege that a prudent fiduciary could not have concluded that stopping a purchase of employer stock or disclosing nonpublic information would do the plan more harm than good.

Implications for Fiduciaries

In *Dudenhoeffer*'s wake, a plan sponsor may wish to consider excluding personnel with access to inside information from serving on plan committees. Alternatively, a plan sponsor may want to consider appointing an independent fiduciary who would not be in a position to possess material nonpublic information. Fiduciaries who have inside information should consider engaging legal counsel concerning their obligations under federal securities laws. Fiduciaries may want to review their current practices and procedures to determine whether any changes need to be made on the basis of *Dudenhoeffer*. As with any investment decision, plan fiduciaries must engage in a prudent process that includes holding regular investment committee meetings and maintaining minutes of such meetings.

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