More on *Moench*

Marcia S. Wagner, Esq.

Stock drop claims alleging imprudence on the part of plan sponsors and other fiduciaries in maintaining employer stock as a plan investment option have become a common type of litigation involving 401(k) plans. Courts have struggled to resolve the tension between legislative intent favoring such investments and the duty of an ERISA fiduciary to act prudently when the plan sponsor experiences financial distress, as manifested in connection with events such as the subprime mortgage crisis and ensuing recession.

Relying on the leading case of *Moench v. Robertson*, a number of courts have held that a fiduciary investing in company stock is entitled to a presumption that it acted consistently with ERISA. Two recent Circuit Court of Appeals cases, decided one day apart last September, apply this presumption in contradictory ways.

The GlaxoSmithKline Case. Where the terms of a plan indicate an intention to offer an employer stock fund to employees as an investment option, some courts have held that plan fiduciaries are not required to cease purchasing employer stock or liquidate the fund when the stock value declines as a result of a negative corporate development. As exemplified by its decision in *In re GlaxoSmithKline ERISA Litigation*, the Second Circuit falls into this category.

The district court in *GlaxoSmithKline* ("GSK") dismissed the complaint on the ground that the 401(k) plan documents afforded the defendants "no fiduciary discretion" with regard to offering employer stock as an investment option. In affirming, the appellate court, while noting that the law in the Second Circuit is "not quite that absolute," held that the plan fiduciaries were entitled to the *Moench* presumption of prudence. Quoting from its prior decision in *In re Citigroup ERISA Litigation*, the Second Circuit stated that "a fiduciary's failure to divest from company stock is less likely to constitute an abuse of discretion if the plan's terms require—rather than merely permit—investment in company stock."

The GSK 401(k) plan designated the employer stock fund as the plan's default investment where employees failed to select another investment option for certain employer-funded contributions. Given the court's view that these terms strongly favored investment in employer stock, the plaintiffs could overcome *Moench's* presumption of prudence only by showing that circumstances placed the plan employer in a "dire situation" that could not have been foreseen when the plan was established and under which the party that established the plan would not have intended for the plan fiduciaries to continue investing in employer stock. While showing the employer's impending collapse was not required for this purpose, allegations that GSK suffered manufacturing, marketing, and safety problems were not sufficient to allow the case to go forward.

The *GSK* decision is also notable because it was made at an early stage in the litigation and rejected the plaintiff's request for a remand to the district court. In this regard, the Second Circuit observed that "determining whether a complaint states a claim is a task well within an appellate court's core competency." The defendants were undoubtedly pleased that the court was willing to rely on the pleadings' failure to rebut the *Moench* presumption, since it allowed them, at a minimum, to avoid expensive and potentially damaging discovery.

The Dudenhoefer v. Fifth Third Bancorp Case. In the *Dudenhoefer* case, the Sixth Circuit Court of Appeals disagreed that the presumption of prudence should be applied at the pleadings stage of a stock drop case. This led to a reversal of the district court's granting of the plan sponsor's motion to dismiss for failure to state a plausible claim.

Reviewing prior Sixth Circuit case law, the *Dudenhoefer* court determined that the presumption of prudence is an evidentiary rule, not a pleading requirement. Therefore, the presumption can be applied by a court under the jurisdiction of the Sixth Circuit only after the development of an evidentiary record. This could occur on a motion for summary judgment, but not simply by examining the complaint on a motion to dismiss.

The procedural distinction adopted by the Sixth Circuit stems from its view of the substantive standard to be applied to a plaintiff's rebuttal of the presumption of prudence. Other circuit courts, such as the Second Circuit, require a plaintiff to prove that the employer faced a dire situation that was objectively unforeseeable by the plan settlor. However, Sixth Circuit precedent only requires a plaintiff to show that a prudent fiduciary acting under similar circumstances would have decided to discontinue the employer stock investment. This test is fact-based and cannot be applied simply by referring to the adequacy of a complaint.

According to the Sixth Circuit, the proper test for allowing the case to move forward at the pleadings stage is simply whether the complaint contains facts sufficient to plausibly allege a breach of fiduciary duty and a causal connection between the breach and the investment losses suffered by the plan.

The plan sponsor in *Dudenhoefer* was a bank that allegedly shifted from being a conservative lender to a subprime lender, thereby compromising its loan portfolio and rendering the

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plan's investment in its stock imprudent. While this might not have successfully rebutted the presumption of prudence required by the classic *Moench* test, it was sufficient to pass the Sixth Circuit's more basic pleading standard.

Conclusion. Courts, such as the Second Circuit, tend to view inclusion of an employer stock fund on a 401(k) plan's investment menu as a design decision that, if properly reflected in the plan documents, resolves the question of whether fiduciary duties have been satisfied. This has motivated legal advisors to recommend that, where employer stock is to be made available through a 401(k) or other individual account plan, the feature be embedded in the plan's language in the strongest possible terms. It appears that this approach will not work in the Sixth Circuit where the test for rebutting the presumption of prudence is whether a prudent fiduciary would have made a different investment decision. ❖

Marcia S. Wagner is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or Marcia@WagnerLawGroup.com.