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ERISA "Stock Drop" Cases: Should Plan Fiduciaries Rest Easy?

By Mark E. Bokert and Alan Hahn

Prior to 2014, many federal courts applied a "presumption of prudence" standard when evaluating a fiduciary's decision to offer employer stock as an investment option under their company's retirement plan. However, *Fifth Third Bancorp v. Dudenhoeffer*,[1] drastically changed this, as the U.S. Supreme Court abolished the presumption of prudence and modified the pleading standards that plaintiffs must satisfy to state a viable claim for breach of fiduciary duty when the price of employer stock offered under a retirement plan drops. As a result of these modified pleading standards, plaintiffs face an uphill battle to bring successful claims. Nevertheless, the risk of litigation in this area persists. This column explains the pre- and post-*Dudenhoeffer* legal landscape as well as considerations for plan fiduciaries as to how to reduce their fiduciary risk.

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BACKGROUND

ERISA Fiduciary Duties

While ERISA generally requires fiduciaries to diversify plan investments offered to participants, there is an exception to this general rule which permits eligible individual account plans to offer employer stock to participants. More specifically, a plan fiduciary must "diversif[y] the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so."[2] However, "[i]n the case of an eligible individual account plan, the diversification requirement . . . is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities."[3] Therefore, under ERISA, individual account plans are allowed to offer non-diversified stock of the plan sponsor to participants.

While permitting employer stock investments, ERISA also states that a plan fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[4] This is a high standard of conduct and requires plan fiduciaries to act like prudent experts. To satisfy this duty, when confronted with a decision, plan fiduciaries must gather relevant information, analyze the information, seek expert advice (e.g., from investment advisors and counsel), and make a well-reasoned decision based on the gathered information. Importantly, this duty requires plan fiduciaries to consider the "circumstances then prevailing" – meaning as context and facts change, a plan fiduciary is required to revisit and reconsider earlier decisions.

Further, ERISA states that a plan fiduciary must also act "solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries."[5] Thus, a plan fiduciary, when confronted with a decision, must place the interests of the plan participants above all else. This duty of loyalty, as well as the duty of prudence, apply to the selection and monitoring of plan investments.[6]

*Pleading Standard Pre-*Dudenhoeffer

Historically, when deciding lawsuits which challenged fiduciary decisions to offer employer stock as an investment option, courts found themselves in a conundrum as to how to reconcile ERISA's general duties of prudence and loyalty with ERISA's express authorization to allow employer stock as a plan investment option. In an attempt to harmonize these seemingly opposing provisions of ERISA, many federal courts adopted a "presumption of prudence" standard for plan fiduciaries,

commonly known as the *Moench* presumption. Under this standard, named after the federal circuit court case *Moench v. Robertson*,[7] plan fiduciaries that offered employer stock as an investment option under their retirement plan were presumed to have acted prudently when making such offering. The burden to overcome this presumption was on the plaintiffs.

Pleading Standard in Dudenhoeffer

In June 2014, the U.S. Supreme Court in *Dudenhoeffer* determined that fiduciaries under ERISA are not entitled to a presumption of prudence when they decide to offer or retain employer stock as an investment alternative under their company's retirement plan. Instead, the Court applied a revised standard which contemplated that plaintiffs could base their claims only on publicly available information or non-public/"inside" information. Although there was some fear that overruling the *Moench* presumption would make it easier for plaintiffs in stock drop cases to survive a motion to dismiss, this has not generally been the case.

Dudenhoeffer, like many if not most "stock drop" cases, generally involved employer stock trading at a particular level followed by a steep price drop, resulting in plaintiffs alleging that the plan fiduciaries should have known (or actually knew) that the stock was overvalued relative to its actual value, and should have therefore acted prudently and in the best interests of the participants by freezing or terminating the stock fund before the actual price dropped to prevent plan participants from incurring losses.

With regard to the theory that fiduciaries should have known on the basis of publicly-available information that their employer stock was overvalued, 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."[8] The Court based its holding on the reasoning that the stock markets are presumed to work efficiently and to provide the best estimate of the value of the stocks traded on them. Thus, if a plaintiff brings a lawsuit alleging that plan fiduciaries should have known that their employer stock was overvalued based on public information (e.g., news reports, analyst reports, SEC information), the lawsuit will likely be dismissed unless the plaintiffs can plead specific facts which show "special circumstances." The Court, however, declined to address the meaning of "special circumstances."

With regard to the theory that fiduciaries were aware of insider information that, if publicly known, would negatively impact the value of the stock, the Court held that plaintiffs 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."[9] Thus, if a plaintiff brings a lawsuit alleging that plan fiduciaries should have known that their employer stock was overvalued based on insider information (e.g., accounting statements, product failures) and failed to take action, the lawsuit will likely be dismissed unless the plaintiffs can plead an alternative course of action that is consistent with securities laws and which no prudent fiduciary in the same circumstances could conclude is more harmful to the plan than if the fiduciary did nothing.

*POST-*DUDENHOEFFER *CASES*

Since *Dudenhoeffer,* plaintiffs in numerous cases have attempted to overcome the Court's revised pleading standard, and asserted claims based either on public information or non-public/"insider information." A review of these cases shows that *Dudenhoeffer* has made it quite difficult for plaintiffs to successfully assert ERISA fiduciary breach claims in "stock drop" actions.

Publicly-Available Information

As the cases discussed below indicate, ERISA fiduciary breach claims based on publicly available information are difficult to successfully plead. Absent "special circumstances," which most courts have not found to exist, courts tend to defer to the market price of a stock as being an accurate assessment of the stock's value in light of all public information.

Coburn v. Evercore Trust Co., N.A.[10]

Evercore was a wealth management firm serving as the designated fiduciary and investment manager for the JC Penney retirement plans. In this role, Evercore had the authority to eliminate the employer stock as an investment option under the plans. After JC Penney's stock price precipitously tumbled between 2012 and 2013, plaintiffs claimed that Evercore breached its duty of prudence by failing to prevent plan participants from investing in the stock through their retirement plans. Among other things, participants claimed that, based on publicly available information, the ESOP fiduciary knew that continued investment in JC Penney stock was imprudent. In dismissing the case, the court determined that a "security price in an efficient market 'represents the market's most accurate estimate of the value of a particular security based on its riskiness

and the future net income flows that investors holding that security are likely to receive' . . . echoing this theory, *Dudenhoeffer* agreed that a fiduciary's failure to outsmart a presumptively efficient market . . . [is] not a sound basis for imposing liability."[11]

Saumer v. Cliffs Nat. Res. Inc.[12]

In reconsidering a motion to dismiss, the court found that "ERISA fiduciaries may prudently rely on the market price of a stock as an unbiased assessment of a security's value in light of all the public information and that, absent special circumstances affecting the reliability of the market price, a claim for breach of the duty to prudently manage the stock based solely on public information cannot stand."[13]

In re Citigroup ERISA Litigation[14]

Plaintiffs alleged that defendants acted imprudently by continuing to allow the plaintiffs to invest in Citigroup common stock at a time when Citigroup stock was falling drastically. In dismissing the claim, the court focused on the Supreme Court's holding that "public knowledge" stock drop cases are generally implausible, noting that "fiduciaries may find themselves between a rock and a hard place, because they will be second guessed if they sell the stock and the stock goes up, or if they fail to sell the stock and the stock continues to go down."[15]

Inside Information

As the cases below indicate, ERISA fiduciary breach claims based on "insider" information are also difficult to successfully plead. In particular, the requirement that plaintiffs plead an alternative course of action, and that no other prudent fiduciary could find that the alternative does more harm than good, is difficult for plaintiffs to overcome.

In at least one case, plaintiffs survived a motion to dismiss because the court found that the insider information would have been eventually disclosed to the public, so any harm in the proffered alternative course of action would have been inevitable.[16] But this case represents the minority and does not reflect the high hurdle that plaintiffs must clear.

In re HP ERISA Litigation[17]

Plaintiffs asserted that defendant HP covered up information about accounting irregularities at a subsidiary, Autonomy. Because HP's stock

value declined when the cover up was discovered, plaintiff alleged that HP could have taken two alternative actions, both of which a prudent fiduciary would not have found to do more harm than good. The first course of action was to restrict transactions or new investments by the plan in HP stock, and the second was publicly disclose its intentions to hide or conceal Autonomy's accounting practices. Finding for the defendants, the court indicated that the "more harm than good" standard was not met and stated that "the market impact of freezing the HP Fund as a result of concerns over Autonomy likely would have been dire, and a prudent manager could have – likely, would have, under the circumstances here – waited to investigate the existence and extent of a third-party fraud before disclosing it to the market."[18]

In re Pilgram's Pride Stock Investment Plan Litigation[19]

In support of the claim that fiduciaries continued to hold stock investments despite allegedly having knowledge of inside information showing overvaluing of the stock, plaintiffs advanced four alternative actions that defendants could have taken:

(i) Publicly disclose all negative financial information which plaintiffs alleged caused the stock to be overvalued;

(ii) Terminate the employer stock fund and transfer the stock into other plan investments or cash;

(iii) Resign as fiduciaries and appoint outside advisors; and

(iv) Seek guidance from the SEC or DOL.

In response to (i) and (ii), the court essentially said that such actions would have spelled disaster for the price of the employer stock. In response to (iii) and (iv), the court essentially said that such actions would have accomplished nothing. Consequently, the court dismissed the case.

In re JPMorgan Chase & Co. ERISA Litigation[20]

Plaintiffs asserted that JPM concealed risk-escalating trades which resulted in losses of billions of dollars. Proposed alternative courses of action asserted by plaintiffs included freezing the purchases of JPM stock and/or public disclosure. In holding for the defendants, the court remarked that either course of action would have required the defendants to make JPM's purported misconduct public, and a prudent fiduciary

could plausibly have viewed such public actions as more likely to do more harm than good.

Perrone v. Johnson & Johnson[21]

Plaintiffs alleged that the plan's fiduciaries knew, or at least should have known, that J&J was hiding information about dangerous products and that J&J's stock price was therefore overvalued, yet they continued to hold and purchase J&J stock. Plaintiffs maintained that fiduciaries breached ERISA by failing to protect participants from the "inevitable" stock price decrease by either issuing public disclosures or by freezing J&J stock investments. The court, however, held that the plaintiffs failed to adequately plead a viable alternative course of action that the fiduciaries could have taken, because a prudent fiduciary could have plausibly viewed the proposed alternative courses of action as more likely to harm than help.

Burke v. Boeing Company[22]

Plaintiffs alleged that defendants were aware of potential product issues and should have foreseen how such issues would have led to a drop in Boeing's stock price. However, Boeing had engaged Newport Trust Company as an independent fiduciary to oversee the employer stock offering. The court held that Newport, in making decisions regarding employer stock, was not privy to inside information and was making decisions on the basis of public information as would any other outside investor. The court also held that, by delegating investment decisions to Newport, Boeing did not act in an ERISA fiduciary capacity in connection with the employer stock, and noted that it may have been possible for Boeing to be more vulnerable to a lawsuit if they had not appointed an independent fiduciary.

CONSIDERATIONS

The primary risk in offering employer stock to retirement plan participants is that participants can always assert breaches of fiduciary duty when the price of the employer's stock drops. Even though courts favor plan fiduciaries at the motion to dismiss stage, plaintiff attorneys may wish to test a defendant's willingness to settle versus litigate, and assert breaches nonetheless. Fending off such litigation, even if unlikely to be successful, may consume time, money, resources and result in negative publicity. Accordingly, plan fiduciaries should give consideration to the items discussed below.

Monitoring

Pursuant to ERISA's fiduciary duties, plan fiduciaries are generally required to monitor their investments. Typically, monitoring includes comparing a fund's investment performance versus a relevant benchmark and/or peer group, and evaluating the fund based on other quantitative and qualitative factors. Fiduciaries that offer an employer stock fund should determine, in light of *Dudenhoeffer*, the extent to which employer stock should be monitored.

Pursuant to *Dudenhoeffer* and its progeny, it is clear that fiduciaries may generally rely on the market price of stock unless "special circumstances" are present, which raises the theoretical potential that the market price of employer stock may be deemed unreliable at some point. As such, fiduciaries may wish to monitor for special circumstances, such as any circumstances that potentially relate to the market price's reliability (e.g., via stock trading volume, as prices of thinly traded stock may be less reliable).

Although evaluating employer stock against benchmarks or peer groups does not appear to be an essential component of monitoring, it may nonetheless be valuable when defending a breach of fiduciary claim, since a court may view such efforts favorably as a demonstration of good faith efforts to satisfy fiduciary obligations. Monitoring efforts could also include considering news and analyst information relating to the stock.

Independent Fiduciary

As a result of the 2022 *Boeing* decision, plan fiduciaries may wish to engage an outside investment manager/independent fiduciary to manage decisions with regard to employer stock. Among other things, an independent fiduciary can be responsible for monitoring performance and offering guidance on decisions related to investments in employer stock. Also, appointing an independent investment manager can assist with avoiding possible conflicts of interests for fiduciaries who serve in other roles in the organization. As delegating fiduciary responsibility to an independent investment manager is itself a fiduciary function, care must be exercised when selecting and monitoring the independent fiduciary.

Procedural Prudence

As a general rule, plan fiduciaries should maintain rigorous processes, including establishing, maintaining and periodically reviewing formal, clearly documented processes when making investment-related and/or provider decisions for the plan. In the case of an employer stock fund, a

prudent process may include creating a document trail establishing that no "special circumstances" make it imprudent to rely on the market price as the best available estimate of the stock's value, offering employer stock affirmatively promotes the plan's purpose of enabling retirement savings, and is prudent and in participants' best interests, and that the fiduciaries have potentially evaluated the role of an outside investment manager/independent fiduciary in connection with any employer stock decision.

Participant Education

Fiduciaries will likely want to educate participants about the risks of investing in an employer stock fund. Education efforts will likely be viewed favorably by a court as evidence that the employer stock fund was prudently offered. Information about the company, its stock, and the pitfalls and benefits of investing in employer stock, should all be provided to participants at reasonable intervals. Participants should also be made aware of the different tax impact when making a withdrawal of employer stock from the plan versus other investment funds.

CONCLUSION

Since *Dudenhoeffer*, plaintiffs have had great difficulty successfully suing plan fiduciaries for breach of fiduciary duty in stock drop cases. This is a result of the strict pleading standards established under *Dudenhoeffer*. Nevertheless, the risk of litigation persists. To avoid litigation, or to put themselves in the best position to mount a defense, plan fiduciaries should convene with their ERISA counsel to consider a number of actions, such as monitoring the employer stock fund, appointing an independent fiduciary, providing participant education and utilizing rigorous procedural prudence.

Notes

1. 134 S. Ct. 2459 (2014).
2. ERISA §404(a)(1)(C).
3. ERISA §404(a)(2).
4. ERISA §404(a)(1)(B).
5. ERISA §404(a)(1)(A).
6. See, e.g., DOL Advisory Opinion 1998-04A (May 28, 1998).
7. 62 F.3d 553 (3d Cir. 1995).

8. 134 S. Ct. at 2471.

9. Id.

10. 844 F.3d 965 (D.C. Cir. 2016).

11. Id. at 969.

12. No. 1:15-cv--954, 2016 U.S. Dist. LEXIS 79087 (N.D. Ohio 2016).

13. Id. at 79087, *2.

14. 112 F. Supp. 3d 156 (S.D.N.Y. 2015).

15. Id. at 158.

16. Jander v. Retirement Plans Committee of IBM (910 F.3d 620 (2d Cir. 2018).

17. No. 12-cv-6199, 2015 U.S. Dist. LEXIS 78007 (N.D. Cal. 2015).

18. Id. at 78007, *25.

19. No. 2:08-cv-472, 2016 WL 8814356 (E.D. Texas 2016).

20. No. 12-cv-04027, 2016 WL 110521 (S.D.N.Y. 2016).

21. 48 F.4th 166 (3d Cir. 2022).

22. 42 F.4th 716 (7th Cir. 2022).

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