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Inside the Courts

An Update From Skadden Securities Litigators

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Supreme Court Holds No Presumption of Prudence for ESOP Fiduciaries

Today, in a unanimous decision, the Supreme Court of the United States held in *Fifth Third Bancorp v. Dudenhoeffer* that fiduciaries of employee stock ownership plans (ESOPs) that invest in the employer's securities are not protected by a presumption that they have acted prudently in making those investment decisions. Rather, they are subject to the same duty of prudence as any other ERISA plan fiduciary, except that they need not diversify the fund's assets. Justice Stephen Breyer wrote the opinion for the Court, which vacated the decision of the U.S. Court of Appeals for the Sixth Circuit.

This case arises from claims by Fifth Third ESOP participants that the plan fiduciaries had breached their fiduciary duties by investing plan assets in Fifth Third's stock. The Sixth Circuit held that, under notice pleading principles, the complaint adequately alleged that a prudent fiduciary acting under similar circumstances would have diversified the plan's investments. The Court of Appeals held that a presumption of prudence applies to the actions of plan fiduciaries, but only as an evidentiary matter, not at the pleading stage. Several circuits had applied the presumption in conflicting ways.

The Supreme Court's opinion in *Fifth Third* seeks to bring clarity and uniformity to this area of the law. Foremost, the Court rejects the claim that ERISA creates a special presumption of prudence applicable to ESOP plan fiduciaries. Although ESOP fiduciaries are not liable for losses that arise from a failure to diversify the plan's investments — because ERISA encourages ESOP investments in employer securities — they are subject to ERISA's general duty of prudence in making those investments. In other words, a plaintiff cannot claim that the fiduciaries were imprudent merely because the plan failed to diversity its investments. To bring a claim, they must say more.

Although the Court rejects a presumption of prudence, the Court recognizes the risk of meritless claims and highlights the motion to dismiss as a mechanism for weeding out those claims. The Court vacates the judgment below and remands for further consideration in light of the proper legal framework. In doing so, the Court makes a few observations. First, "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 a stock are implausible as a general rule." Second, where the claim is based on a failure to act on nonpublic information, the claim must recognize that fiduciaries cannot be required to break the law, such as by insider trading. Likewise, where the claim is based on a decision not to trade, the court evaluating a motion to dismiss should consider whether not trading would create disclosure issues or would depress the stock price and thereby harm the fund.