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June 27, 2014

Supreme Court Rejects Presumption of Prudence for Company Stock, but Hurdles for Plaintiffs Remain

This week, the U. S. Supreme Court rejected a long-standing “presumption of prudence” that protected an ERISA fiduciary’s decision to allow qualified retirement plan participants to invest in company stock. However, the Court established an alternative legal framework that, while not a blanket presumption, will still grant substantial protection to fiduciaries.

Background. *Fifth Third Bancorp v. Dudenhoeffer* involved a lawsuit brought by participants who were allowed to invest their 401(k) plan accounts in Fifth Third’s publicly traded stock.

Following a substantial decrease in the price of the company stock, the participants alleged that the plan’s fiduciaries violated ERISA’s prudence requirement by failing, on the basis of both public and non-public information (to which the fiduciaries were privy as company insiders), to:

- sell the plan’s company stock;
- stop future purchases of company stock; or
- disclose inside information to the public so that the market would adjust the price of company stock and prevent the plan from “overpaying” for stock that it continued to purchase.

The Supreme Court’s Ruling. In contrast to a series of cases over the last 20 years, the Court determined that there is no special presumption of prudence for plans invested in company stock. However, the Court laid out a new framework to be used in analyzing stock drop cases which, in most circumstances, may still result in dismissal of participant lawsuits:

- **Claims Based on Public Information.** If participants allege that a fiduciary’s decision to hold and/or continue to purchase publicly traded company stock is imprudent in light of publicly available information, such claims will generally be dismissed. Fiduciaries may rely on the market as a reliable appraisal of the value of company stock, absent special circumstances that suggest that the market is wrong about a company’s value (of which the Court provided no examples).
- **Claims Based on Nonpublic Information.** The Court also created a significant barrier for challenges based on fiduciaries’ access to nonpublic information. Specifically, participants must show that the fiduciaries could have taken action on that information that neither (i) violated securities laws, nor (ii) did more harm than good to the plan. Generally, securities laws prohibit corporate insiders from trading on nonpublic information, and, in the Court’s view, any action taken on the basis of such information would likely have an adverse impact on the plan’s current stock holdings and actually reduce participant benefits. For plans that hold publicly traded company stock, it appears that there are limited actions that a fiduciary could take on the basis of insider information that are both permitted by securities law and would not risk telegraphing negative messages to the market. It may still be possible, however, for participants to allege that a fiduciary could have stopped purchasing company

stock without violating securities laws and without the market necessarily interpreting such action as the company's view that its own stock is a bad investment.

Impact on Closely Held Companies. The ramifications of the Court's decision are less clear for plans of closely held companies, as securities laws operate differently and a fiduciary's options with respect to divesting plans of stock are limited. Now that fiduciaries of such plans cannot rely on the historical presumption of prudence, they may be subject to greater risk following the Court's ruling.

Action Steps. Plan sponsors and fiduciaries of plans invested in company stock (particularly those of closely-held companies) should use this ruling as an opportunity to evaluate their offering of company stock as a plan investment option.

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