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U.S. Supreme Court's Rejection of Moench Presumption: Fifth Third Bancorp. vs. Dudenhoeffer

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Background

Fifth Third Bancorp (the "Company") is a public company which maintained a 401(k) plan containing an employee stock ownership plan ("ESOP") component. The Company matched employee contributions by contributing employer stock to the ESOP, which invested its funds primarily in Company stock. When the **Company's stock value fell**, former employees and ESOP participants **filed a lawsuit against the Company and several of its officers** who were alleged to be fiduciaries of the ESOP. The District Court dismissed the case on the premise that the ESOP fiduciaries were entitled to a "presumption of prudence" in continuing to offer the Company stock as an investment option. The Sixth Circuit reversed this decision, concluding that although ESOP fiduciaries are entitled to a "presumption of prudence" that does not apply to other ERISA fiduciaries, the presumption is an evidentiary one and therefore does not apply at the pleading stage.

The *Moench* Presumption

In the Third Circuit case, Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995), the court stated that "keeping in mind the purpose behind ERISA and the nature of ESOP's themselves . . . An ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA . . . However, the plaintiff may overcome that presumption by establishing the fiduciary abused its discretion." This "presumption of prudence," also known as the "*Moench* Presumption," has been widely accepted by the courts: U.S. Courts of Appeal for the Second Circuit in *In re Citigroup ERISA Litigation*, 662 F.3d 128 (2d. Cir. 2011), and the Ninth Circuit in *Quan v. Computer Sci. Corp.*, 623 F.3d 870 (9th Cir. 2010).

The Supreme Court's Ruling

There is no presumption of prudence to protect ESOP fiduciaries. Plaintiffs must instead demonstrate that the plan fiduciary acted imprudently by plausibly alleging that:

1. where a stock is publicly traded, there were special circumstances requiring a plan fiduciary to have recognized on the basis of publicly available information that the market was overvaluing or undervaluing the stock, or

2. based on inside information, the fiduciaries should have taken an alternative action that the plan fiduciary could have taken, that would have been legal, and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it.

ESOP fiduciaries are put into a difficult position in which they may be sued for imprudence by continuing to invest in company stock, or they may be sued for not following plan documents if they stop investing in company stock, and they can no longer use the *Moench* Presumption which has often caused lawsuits brought against them to be dismissed in the pleadings stage.

Effect on Publicly Traded Companies

This decision may cause more lawsuits to be initiated; however, this would likely primarily affect publicly held companies. For example, the disclosure of inside information to participants is not relevant to privately held companies which usually fund their plans through company contributions, and there are no investment choices for the participants. In addition, if a fiduciary of a privately held company chose not to buy ESOP shares because he knows that the company's most recent valuation is no longer valid due to changes in business conditions and/or the valuation was based on improper information given to the appraiser, he would be violating ERISA, and such disclosure issues are not applicable to privately held companies because there is no market for the shares.

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