Client Alert

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Ninth Circuit Limits Key Defense in ERISA Stock Drop Cases

By Paul Flum and Raymond M. Hasu

On June 4, 2013, the Ninth Circuit issued an opinion in *Harris v. Amgen*, reversing an order granting a motion to dismiss and reviving a class action ERISA lawsuit based on allegedly imprudent investments in company stock. In doing so, the court significantly limited the scope of the "presumption of prudence," a key legal defense in such cases.

BACKGROUND

ERISA imposes a "prudent person" standard of care on plan fiduciaries. To comply with that standard, a fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man 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."

In applying the "prudent person" standard to cases involving investment in employer stock, courts have increasingly applied a deferential presumption of prudence. In a 2010 decision, *Quan v. Computer Sciences Corporation*, the Ninth Circuit adopted the presumption of prudence. To rebut this presumption, a plaintiff must establish that "the company's viability as an ongoing concern" was in jeopardy or "show a precipitous decline in the employer's stock . . . combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement."

The defendants in *Harris* relied heavily on the presumption of prudence. The plaintiffs in that case alleged that the defendants had breached their fiduciary duties under ERISA by allowing participants in Amgen's two employee stock ownership plans to invest in Amgen stock. Accordingly to the plaintiffs, the price of Amgen stock was artificially inflated by the company's false and misleading statements concerning the safety of certain of Amgen's drugs. Plaintiffs further contended that the defendants knew or should have known the undisclosed truth concerning the safety of Amgen's products, yet imprudently continued to allow plan participants to invest in company stock. The trial court granted defendants' motion to dismiss based on *Quan*, ruling that defendants were entitled to a presumption that their actions were prudent, and that the plaintiffs had failed to plead facts satisfying the heightened showing necessary to rebut the presumption.

NEW CONSTRAINTS ON THE PRESUMPTION OF PRUDENCE

The Ninth Circuit reversed, holding that the presumption of prudence was not available based on the facts alleged in the complaint. The Ninth Circuit limited application of the presumption to cases "when plan terms *require* or *encourage* the fiduciary to invest primarily in employer stock." (emphasis added). Because the Amgen plan permitted, but did not require, the fiduciaries to permit investment in company stock, the court found that the

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presumption of prudence did not apply. The court likewise found that the plan documents did not encourage fiduciaries to allow company stock investment.

ERISA PLAN DRAFTING AFTER *HARRIS*

In light of the new ground rules set forth in *Harris*, employers should consider amendments to their ERISA plans. Employers wishing to offer a company stock investment option in their 401(k) plans should consider making it mandatory rather than discretionary. In addition, limits on the amount of company stock that may be held in individual accounts should be revisited in light of the *Harris* ruling that such limits represent discouragements of investment in company stock that are inconsistent with the presumption of prudence.

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