Mostly Good News for Defendants in ERISA Stock-Drop Cases

Most public companies offer their own stock as one investment option in their 401(k) plans. Over the past several years, many have seen some of their stock price drop, even if it later rebounded. These circumstances are often enough to prompt lawyers to target a company for an ERISA "stock drop" lawsuit, claiming that plan fiduciaries should not have allowed investments in company stock during periods of price decrease, and should have provided much more cautionary information to participants, perhaps even non-public inside information. Courts have become increasingly skeptical of such claims absent compelling facts, and are increasingly willing to dismiss them on the pleadings alone. Several recent decisions continuing the trend favoring defendants are particularly worth noting.

The leading case establishing a higher standard for suing plan fiduciaries in relation to company stock is *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). *Moench* recognized a "presumption of prudence" when plan fiduciaries allow company stock as an investment option. See *id.* at 571. Rebutting that presumption requires a substantial showing. *Id. Moench* has been followed by most circuit courts of appeal.
In the 15 years since Moench, litigation has focused on a number of key issues, all of which have been the subject of very recent cases:

- Is the *Moench* presumption a standard applicable at the pleadings stage on a Rule 12 motion, or is it an evidentiary presumption that comes into play later?
- Does *Moench* apply only when the company stock investment option is mandated by an Employee Stock Option Plan ("ESOP"), or does it apply to any Eligible Individual Account Plan ("EIAP") that allows investment in company stock, even if such investment is not required?
- What is required to rebut the presumption, including on a Rule 12 motion to dismiss under *Bell Atlantic Corp. v. Twombley*, 550 U.S. 544 (2007)?
- Does ERISA Section 404(c), which provides a "safe harbor" when a plan holds each participant's assets in a separate account and enables the participant to exercise control over his or her own assets, also protect plan fiduciaries from claims that company stock should not have been selected or continued as an investment option?
- Can a misrepresentation claim be based on statements in SEC filings?
- To state a viable misrepresentation claim, must a plaintiff plausibly allege actual reliance on the alleged misrepresentation?

Two recent cases discussed the interplay between the Section 404(c) safe harbor and claims against fiduciaries alleging it was imprudent to offer company stock as an option. *Pfeil v. State Street Bank and Trust*, 2010 WL 3937165 (E.D. Mich. Sept. 30, 2010) addressed the General Motors ESOP. The court held that the plaintiff had alleged facts sufficient to state a claim that the fiduciary acted imprudently in continuing to offer GM stock as an option in the face of numerous "red flags" as GM headed toward bankruptcy. See *Id.* at *5. The court granted a motion to dismiss, noting that Section 404(c) relieves a fiduciary of liability for a loss "caused" by the participant's exercise of control over his or her assets. See *id.* at *5. Finding that it was undisputed that the plan offered other investment options not at issue, that the participants "had total control over how to allocate their assets," since the fiduciary "cannot be held liable for actions which Plaintiffs controlled," the court held that "Plaintiffs cannot show causation." *Id.* at *6.

The Department of Labor has filed amicus briefs in several cases, maintaining its position that the Section 404(c) safe harbor should not apply to the selection or continuation of company stock as an investment option.

In *Howell v. Motorola*, 2011 WL 183966 (7th Cir. Jan. 21, 2011), the Seventh Circuit agreed with the Department of Labor, noting that "the purpose of section 404(c) is to relieve the fiduciary of responsibility for choices made by someone beyond its control," but that "the choice of which investments will be presented in the menu that the plan sponsor adopts is not within the participant's power." For that reason, the court distinguished an earlier opinion suggesting a different conclusion, and instead followed *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007). See *Howell*, 2011 WL 183966 at *15. It held that "the selection of plan investment options and the decision to continue offering a particular investment vehicle are acts to which fiduciary duties attach, and that the safe harbor is not available for such acts." *Id.*

Nevertheless, the court found the presumption of prudence applied and that the plaintiffs could not overcome that presumption. See *id.* at *15. Even though it rejected Section 404(c) as an absolute defense, it found that the availability of other investment options, and the ability of participants to "move their dollars away from the Motorola stock fund into a different fund," ensured that "no participant's retirement portfolio could be held hostage to Motorola's fortunes." *Id.* at *16-17. The court also noted that despite the stock drop at that time, Motorola was by no means facing "imminent collapse"—the test many courts use when applying the *Moench* presumption—and was "fundamentally a sound company." *Id.* at *17.

After many missed opportunities, the Ninth Circuit finally adopted the Moench presumption in *Quan v. Computer Scis. Corp.*, 623 F.3d 870 (9th Cir. 2010). The court acknowledged that its historical reluctance to follow *Moench* "was that it was not sufficiently deferential to or protective of fiduciaries, not that it placed too great a burden on those asserting breach-of-fiduciary duty claims." *Id. Quan* held that the deferential *Moench* presumption applies not just to mandatory ESOPs, but also to all EIAPs when "plan terms require or encourage the fiduciary to invest primarily in employer stock." *Id.* Without expressly saying that Section 404(c) also applies to fiduciary decisions to allow investments in company stock, the court stated that applying the *Moench* presumption "will allow fiduciaries to 'fulfill their duties in the safe harbor that Congress seems to have intended to provide them' for managing EIAPs and ESOPs." *Id.* at 882. *Quan* also articulated a high standard concerning "how bad do things have to be" before reasonable fiduciary would disallow company stock as a permitted investment. *Id.* Following other courts that reached similar conclusions, it held that plaintiffs must make plausible allegations that either "clearly implicate the company's viability as an ongoing concern," or show both "a precipitous decline" in the stock price together with other evidence "that the company is on the brink of collapse or is undergoing serious mismanagement." *Id.*

Other courts have also applied *Moench* broadly. In *Dudenhoeffer v. Fifth Third Bancorp*, 2010 WL 4970767 (S.D. Ohio Nov. 24, 2010), an Ohio court granted a motion to dismiss, holding that the principal inquiry is whether the particular fund "invests primarily in qualifying employer securities." Other cases applying *Moench* to EIAPs include *In re Bank of America Corp. Sec., Derivative and ERISA Litig.*, 2010 WL 3448197 (S.D.N.Y. Aug. 27, 2010) *Wright v. Medtronic*, 2011 WL 31501 (D.Minn. Jan. 5, 2011) and *Acosta v. MEMC*, 2010 WL 4069202 (E.D. Mo. Oct. 18, 2010).

The Southern District of New York has rendered many recent opinions in "stock drop" cases, including suits related to the inclusion of company stock in the Bear Stearns, American Express, Bank of America, Citibank, and Sallie Mae plans. The opinion in *In re Bear Stearns Cos., Inc. Sec., Derivative and ERISA Litig.*, 2011 WL 223540 (S.D.N.Y. Jan. 19, 2011), contains an exhaustive discussion of fiduciary duties in relation to company stock. The *Bear Stearns* court dismissed all breach of fiduciary duty claims. Rejecting its earlier holding to the contrary in *In re Morgan Stanley ERISA Litig.*, 696 F. Supp. 2d 345 (S.D.N.Y. 2009), it held that the *Moench* presumption applies at the motion to dismiss stage. See 2011 WL 223540, at *133. *Bear Stearns* also emphasized that the *Moench* presumption is a "substantial shield," and creates a very high bar for the plaintiff in suits alleging the improper selection and continuation of the company stock investment option. *Id.* at *134. The court then held that allegations that the stock plummeted from $171 to $5 per share were insufficient to survive a Rule 12 motion notwithstanding the further allegations that the shares had been artificially inflated by misrepresentations and omissions, and that the company was grossly mismanaged and in such financial extremes that it collapsed during the alleged class period. *Id.* at *135-36. The court deemed such allegations conclusory and held that when a plaintiff alleges a danger of imminent collapse, he or she must be specific as to exactly when the danger existed, and when the fiduciaries should have known of it. *Id.* at *136; *see also In re Bank of America Corp. Sec., Derivative and ERISA Litig.*, 2010 WL 3448197 (S.D.N.Y. Aug. 27, 2010) *Bear Stearns* also held, as have other courts, that plan fiduciaries are not "investment advisors" and have no duty to disclose non-public information to plan participants, even if such information would be highly relevant to the prospects for the company stock. *In re Bear Stearns*, 2011 WL 223540 at *133; *see also In Re Constellation Energy ERISA Litig.*, 2010 WL 3221821 (D. Md. Aug. 13, 2010).

Three other cases have recently applied the *Moench* presumption at the motion to dismiss stage, adopting analyses similar to that followed in *Bear Stearns*. See *In re Bank of America Corp Sec. Derivative and ERISA Litig.*, *In re SLM Corp ERISA Litig.*, 2010 WL 3910566 (S.D.N.Y. Sept. 24, 2010), and *In re American Express Cos. ERISA Litig.*, 2010 WL 4371434 (S.D.N.Y. Nov. 2, 2010).

In *Wright v. Medtronic*, 2011 WL 31501 (D. Minn. Jan. 5, 2011) (granting motion to dismiss), the court held that when alleging misrepresentations concerning company stock, an ERISA plaintiff must also allege actual reliance on the misrepresentation and that the misrepresentation caused the alleged loss. It held that under ERISA, there is no "fraud on the market" presumption of reliance similar to that allowed under the securities laws. See *id.* at *6.

Recent cases holding that public statements in SEC filings, press releases, and other public disclosures are not actionable as against plan fiduciaries include *Bear Stearns, Bank of America, Sallie Mae, Wright,* and *In re RH Donnelley ERISA Litig.*, 2011 WL 86623 (N.D. Ill. Jan. 10, 2011).

Although some recent decisions have not been as favorable to the defendants, it is fair to say that in general the judiciary has been increasingly protective of plan fiduciaries with respect to decisions to include company stock.