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New Developments in the Presumption of Prudence Under ERISA: A Dramatic Increase in Liability Exposure Hangs on the Difference Between "Shall" and "May"

By Stephen A. Fogdall

Recent decisions out of the Second and Ninth Circuits have increased the liability exposure of plan fiduciaries under the Employee Retirement Income Security Act (ERISA) where the retirement plan gives employees an option to invest in the employer's stock. If the plan permits, but does not require, that this investment option be available, plan fiduciaries can be held liable if they fail to withdraw the option once they become aware, or should be aware, that the value of the employer's stock may be artificially inflated.

ERISA pulls in potentially conflicting directions. On the one hand, the statute was enacted to "assure the equitable character" and "financial soundness" of employee retirement plans. *Moench v. Robertson*, 62 F.3d 553, 560 (3d Cir. 1995) (internal quotation marks and alterations omitted). To achieve that end, ERISA mandates that a retirement plan name one or more fiduciaries to manage the assets "solely in the interests of the participants and beneficiaries" (known as the duty of loyalty) and "with the care, skill, prudence and diligence" of a "prudent man" in "the conduct of an enterprise of a like character with like aims" (known as the duty of care). 29 U.S.C. § 1104(a)(1). On the other hand, ERISA allows the employer to establish an Employee Stock Ownership Plan (ESOP), designed to invest primarily in the employer's own stock, which necessarily restricts the investment choices of plan fiduciaries without relieving them of these two stringent duties. The Third Circuit resolved this tension in its groundbreaking decision in *Moench* by holding that "an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." 62 F.3d at 571.

The Third Circuit extended this "presumption of prudence" to a broader category of employer-stock investment options known under ERISA as Eligible Individual Account Plans (EIAPs) in *Edgar v. Avaya, Inc.*, 503 F.3d 340 (3d Cir. 2007). In *Edgar*, the retirement plan permitted employees to choose among 23 investment options. The plan documents provided that these options "shall include" a fund the assets of which "shall be invested primarily in shares of [the employer's] common stock." *Edgar*, 503 F.3d at 343. The plaintiff in *Edgar* alleged that the plan fiduciaries breached their duties under ERISA by not withdrawing the employer-stock investment option when they became aware of "corporate developments that were likely to have a negative effect on the company's earnings and, therefore, on the value of the company's stock." *Id*. at 348. The court noted that such an action would have required plan fiduciaries to disobey the express terms of the plan. Thus, the court concluded, "the rationale of *Moench* applies equally here," and the plan fiduciaries were entitled to the presumption of prudence. *Id*. at 347.

Moench's presumption of prudence has enjoyed wide acceptance in other federal courts, including the Second, Fifth, Sixth and Ninth Circuits. *In re Citigroup ERISA Litig.*, 662 F.3d 128 (2d Cir. 2011); *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243 (5th Cir. 2008); *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995); *Quan v. Computer Sciences Corp.*, 623 F.3d 870 (9th Cir. 2010). Recently, however, the Second and Ninth Circuits have refused to apply the presumption where the terms of the plan did not mandate the inclusion of the employer-stock investment option.

In *Harris v. Amgen, Inc.*, No. 10-56014 (9th Cir. Jun. 4, 2013), the plan, like that in *Edgar*, offered participants several options. But, unlike the plan in *Edgar*, the plan in *Harris* provided only that these options "may include" a

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fund invested in the employer's common stock. Slip Op. at 22. There was "no language … requiring that a Company Stock Fund be established as an available investment for plan participants." *Id*. The plaintiffs alleged that the plan fiduciaries should have withdrawn the employer stock fund as an investment option because they "knew or should have known" that the fund "was purchasing stock at an artificially inflated price due to material misrepresentations and omissions" regarding risks associated with one of the employer's most successful products. *Id*. at 29. Reversing the district court's dismissal of the action, the Ninth Circuit held that plan fiduciaries were not entitled to the benefit of the presumption of prudence, in part because the plan did not require that an employer stock fund be established or that, "once established, [such a fund] be continued as an available investment." *Id*. at 22.

The Second Circuit, in *Taveras v. UBS AG,* 107 F.3d 436 (2d Cir. 2013), refused to apply the presumption of prudence in similar alleged circumstances. The court explained that if "the presumption of prudence was triggered in every instance where the EIAP plan document, as here, simply (1) named and defined the employer's stock in the plan document's terms, and (2) allowed for the employer's stock to be offered by the plan fiduciaries on a discretionary basis to plan participants, then we are hard pressed to imagine that there exists *any* EIAP that merely offered the option to participants to invest in their employer's stock whose fiduciaries would not be entitled to the presumption of prudence." *Id*. at 445 (emphasis in original).

The holdings in *Harris* and *Taveras* are consistent with the Third Circuit's own treatment of the presumption of prudence, under which the presumption does not apply where plan fiduciaries are "not required to offer [the employer's] stock as one of [the] investment opportunities." *In re Schering-Plough Corporation ERISA Litig.*, 420 F.3d 231, 236 (3d Cir. 2005).

These decisions create an incentive to lock the employer-stock investment option into the plan and eliminate any discretion to remove that option even when plan fiduciaries know it may be risky. It is unclear whether this result truly serves ERISA's underlying purpose of fostering employee retirement income security. However, it does have the benefit of giving an employer clear guidance in how to draft a plan to try to ensure application of the presumption of prudence. A plan that provides that an employer stock fund "shall" be made available likely will qualify for the presumption. A plan that provides only that such a fund "may" be available likely will not. ◆

For more information about Schnader's Financial Services Litigation Practice Group and Employee Benefits Practice Group or to speak with a member of the Firm, please contact:

Stephen A. Fogdall
202-419-4208
sfogdall@schnader.com

Christopher A. Hart
Co-Chair, Financial Services Litigation Practice Group
415-364-6707
chart@schnader.com

Stephen A. Shapiro
Co-Chair, Financial Services Litigation Practice Group
215-751-2259
sshapiro@schnader.com

Jon C. Hughes
Chair, Employee Benefits Practice Group
215-751-2232
jhughes@schnader.com

James R. Olson
Counsel, Employee Benefits Practice Group
412-577-5109
jolson@schnader.com