Supreme Court Gives Ruling on Fifth Third Bancorp Case

In a June 25, 2014 article "Court delivers win to 401(k) plaintiffs," Chuck Epstein reports that employers could be held liable for holding company stock inside ESOP and 401(k) plans, especially if the stock falls in price and company executives failed to act to prevent the losses.

That was the upshot of a U.S. Supreme Court ruling on Wednesday that gave Fifth Third Bancorp employees a second chance in their class-action lawsuit against the Ohio institution. In doing so, however, the court also provided the lower court several guidelines that would seem to weaken the plaintiffs' case. Among them: that a fiduciary should in some way have been able to recognize whether a stock was over- or undervalued.

The suit was brought by employees in the bank's defined contribution plan and ESOP, both of which held company stock that lost over 95 percent of its share price. At issue was whether Fifth Third Bancorp executives should have known, based on publicly available, as well as inside information, that their own company stock was "overpriced and excessively risky," according to the complaint. The high court sent the case, Fifth Third Bancorp v. Dudenhoeffer, back to an appeals court for reconsideration.

In issuing its 9-0 decision, the court discarded the long-accepted doctrine of the presumption of prudence, which has offered plan fiduciaries protection in the event of a decline in asset values. According to the suit, the bank kept offering company stock in its plans even as Fifth Third was increasing its risky subprime lending practices. Eventually, this exposed it to losses in the 2007 housing-led recession. Plaintiff's lawyers filed the class-action on behalf of employees after the stock fell from $42 a share to below $2.

The 2008 suit also charged that as fiduciaries, bank officers should have sold the stock earlier, when the stock price began to decline, refrained from buying more company stock and publicly acknowledged the over-pricing so the market could have corrected itself. The suit said bank officers did not take any action and the price of Fifth Third stock ultimately plummeted, cutting the respondents' retirement savings. In finding that retirement plan and ESOP fiduciaries should not be held to any special presumption of prudence, the court said these fiduciaries are subject to the same duty, or level, of prudence that applies to ERISA fiduciaries in general. That was a win for Fifth Third.

The justices also struck down the argument that Fifth Third officers could have taken action based on insider information because that would have been illegal, since "ERISA's duty of prudence never requires a fiduciary to break the law, and so a fiduciary cannot be imprudent for failing to buy or sell stock in violation of the insider trading laws."

The case highlights the problem of owning company stock in a DC or ESOP.

"Having a retirement plan investing in the plan sponsor's stock is a mistake that can lead to tremendous liability," according to Ary Rosenbaum of the Rosenbaum Law Firm, Garden City, New York. "By allowing the participants to proceed against Fifth Third, it's a warning to those plan sponsors that still offer company stock in their plans. Overall, it's a small victory in the sense that it narrows how plaintiffs can recover. It means plaintiffs need a strong case to prevail."

Another pension expert, Terrance P. Power, president of American Pension Services, based in Clearwater, Florida, also warned against the practice. "As a general rule, I have found during my 33 years in the retirement plan industry that allowing employer stock into a qualified retirement plan can sometimes present some very difficult challenges for plan fiduciaries. We tend to discourage employers from including company stock as an investment option."

However, a June 25, 2014 article by "Supreme Court Ruling Helps 401k plaintiffs", Matthew Heimer reports that even after the ruling, employee-plaintiffs in general are likely to need an unusually strong case to win in a suit over a stock-investment program. William Jay, a partner at the law firm Goodwin Procter in Washington, D.C. who has argued several cases before the Supreme Court, says that plaintiffs in ESOP cases will still need to spell out what their employers should have known about the outlook for company stock, and what they were supposed to have done about it to fulfill their duty to retirement-plan participants.

“A good fiduciary is going to take into account whether advice to employees could hurt the market,” Jay says. Discouraging employees from buying stock could be seen by the investing public as a “danger signal,” he adds, driving down the stock price and hurting employees who already own it. And making such decisions based on information that isn’t already widely known could violate insider-trading regulations. As Breyer writes, “the duty of prudence…does not require a fiduciary to break the law.”

Plan sponsors with employer company stock should carefully review this case and its ramifications on their Plan.

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