VOL. 38, NO. 2 AUTUMN 2012

Employee Relations
LAW JOURNAL

Eleventh Circuit Becomes Latest Circuit to Adopt Rebuttable Presumption That Fiduciaries Act Prudently by Investing in Employer Stock

Douglas A. Sondgeroth and Brienne M. Letourneau

This article explains a recent United States Court of Appeals for the Eleventh Circuit case that adopted the view that ERISA plan fiduciaries do not abuse their discretion by investing in employer stock according to plan terms, as long as it was reasonable to do so under the circumstances.

In *Lanfear v. Home Depot, Inc.*,[1] the United States Court of Appeals for the Eleventh Circuit became the sixth circuit court to expressly adopt the view that ERISA plan fiduciaries do not abuse their discretion by investing in employer stock according to plan terms, as long as it was reasonable to do so under the circumstances.

The Eleventh Circuit's decision is an adaptation of the presumption of prudence first announced in *Moench v. Robertson*,[2] which is commonly referred to as the "*Moench* presumption." In *Lanfear*, however, the court determined that the *Moench* presumption was more appropriately viewed as a standard of review rather than an evidentiary presumption. As a result, it affirmed the district court's dismissal of the plaintiffs' claims under Federal Rule of Civil Procedure 12(b)(6).

This article summarizes this case and identifies important ramifications of the court's decision, which could have an impact on any company that allows its employees to invest in company stock through a benefit plan.

Douglas A. Sondgeroth is a partner at Jenner & Block LLP, where he is a member of the Complex Commercial Litigation, ERISA Litigation, and International Arbitration Practices. Brienne M. Letourneau is an associate in the Litigation Department. The authors may be contacted at *dsondgeroth@jenner.com* and *bletourneau@jenner.com*, respectively.

BACKGROUND

Lanfear concerned a retirement plan Home Depot offered to its employees. The plan was both an eligible individual account plan (EIAP) and an employee stock ownership plan (ESOP), meaning that it allowed participants to decide how to invest their individual accounts and offered company stock as a plan investment option. The plan language provided that one of the eight investment funds available to plan participants be a Company Stock Fund. While participants were given the option to invest either in the Company Stock Fund or in any of the other available funds, all company contributions and matching funds were to be invested initially in the Company Stock Fund. Participants could, however, transfer any investment made on their behalf to any of the other funds the plan offered.

The Plaintiffs' Allegations

The plaintiffs alleged that certain Home Depot stores charged back to vendors the cost of merchandise that those stores fraudulently claimed as defective. As a result of this alleged practice, the plaintiffs claimed Home Depot artificially inflated its earnings and profit margins.

The plaintiffs also alleged Home Depot executives knew of the practice and even encouraged it for two years before they ultimately put a stop to it. The plaintiffs claimed that once the practice came to light, they were harmed because Home Depot's stock price dropped 16.5 percent in roughly two months.

In addition, the plaintiffs pointed to alleged misrepresentations in Home Depot's Securities and Exchange Commission (SEC) filings (including filings specific to the plan itself), as well as a purported revelation by the company that employees had been routinely backdating their stock options over the course of two decades.

The plaintiffs filed a class action against Home Depot and various plan fiduciaries, asserting that they breached ERISA's duty of prudence by continuing to offer Home Depot stock as an investment option and permitting company contributions to be invested in the Company Stock Fund. The plaintiffs further alleged that the defendants breached their duty of loyalty by misleading plan participants via misrepresentations in the company's SEC filings and failing to disclose adequately to plan participants the potential impact of the alleged problems with Home Depot's business practices on the prudence of investing in the Company Stock Fund.

The District Court's Decision

The district court granted the defendants' Federal Rule of Civil Procedure 12(b)(6) motion to dismiss the plaintiffs' claims. The district court concluded that regardless what label the plaintiffs used, the plaintiffs' duty of prudence

claim was really a disguised claim that the defendants failed to diversify the plan's holdings. It concluded that because ERISA expressly exempts fiduciaries of EIAPs and ESOPs from a duty to diversify, ERISA barred the plaintiffs' claim. The district court reasoned further that the plan language requiring investment in Home Depot stock also limited the defendants' discretion and therefore insulated them from judicial review.

The district court also held in the alternative that the plaintiffs failed to overcome the *Moench* presumption because they did not allege that the company was "on the brink of financial collapse." The district court dismissed the duty of loyalty claim because the defendants did not make the allegedly misleading SEC filings in their capacity as ERISA fiduciaries, and they had no duty under ERISA to disclose non-public company information to plan participants.

OPINION

The Eleventh Circuit began its analysis by rejecting the district court's conclusion that the plaintiffs' duty of prudence claim was a camouflaged diversification claim. The court noted that the claim did not concern whether the plan was adequately diversified, but rather challenged the continued offering of company stock as imprudent based on the defendants' knowledge of its allegedly inflated price. The court also observed that the plan did not require the defendants to invest only in company stock. Therefore, contrary to the district court's conclusion, the defendants' exercise of discretion, however limited, was subject to judicial review.

ERISA's Goals

Nevertheless, the court affirmed the district court's dismissal of the plaintiffs' duty of prudence claims based on their failure to overcome the *Moench* presumption. Observing that the "goals of ERISA and the ESOP plans it permits conflict to some extent," the court acknowledged a need to reconcile the two conflicting goals to the extent possible when reviewing the investment decisions of an ESOP fiduciary. The court recognized that, without a presumption of prudence, ESOP fiduciaries could be exposed to fiduciary liability "if they adhered to the plan's terms and the stock price fell or if they deviated from the plan and the stock price rose."

Therefore, the court determined that it would follow at least five previous circuit courts that have expressly adopted the *Moench* presumption.

The court, however, modified the district court's requirement that the company must have been "on the brink of financial collapse." Instead, the court decided that it would review the defendants' investment decisions under an abuse of discretion standard, and therefore would inquire whether the defendants "could not have reasonably

believed that the settlors [of the plan] would have intended" for them to maintain the plan's investment in Home Depot stock "under the circumstances."

Notably, the court rejected the plaintiffs' argument that the *Moench* presumption is an evidentiary inquiry that cannot be applied at the pleading stage. Rather, the court held that *Moench* and other preceding circuit court decisions prescribed a standard of review rather than an evidentiary presumption, and therefore, the standard was applicable on a motion to dismiss.

The Court's Reasoning

Applying the standard to the plaintiffs' complaint, the court reasoned that the plan's settlors intended to design the plan for the long haul, and plan fiduciaries determining whether to maintain the plan's investment in company stock were not required to consider "short-term events and fluctuations in the market" such as those the plaintiffs alleged. The court also stated that to hold otherwise would give plan participants an unfair advantage over ordinary shareholders, who would not have the benefit of the corporate inside information that plan fiduciaries would be expected to utilize in their investment decisions. Finding that the facts pled in the complaint were insufficient to demonstrate an abuse of discretion by the defendants, the court therefore affirmed the dismissal of the duty of prudence claim.

The Duty of Loyalty Ruling

The court also affirmed the dismissal of the duty of loyalty claim on the basis that, in making the allegedly misleading SEC filings, the defendants were not acting as plan fiduciaries but rather in their capacities as corporate representatives. The court also agreed with the district court that ERISA does not impose an affirmative duty on plan fiduciaries to disclose non-public company information to plan participants. The court found that the disclosure in the plan documents of the relative risk of investing in company stock satisfied the defendants' obligations, and declined to import into ERISA a rule that would "convert[] fiduciaries into investment advisors."

RAMIFICATIONS

The Eleventh Circuit's decision to adopt the *Moench* presumption is particularly noteworthy for multiple reasons.

First, to date, the only courts that have dismissed duty of prudence claims by reasoning that they are really camouflaged duty to diversify claims have been district courts in the Northern District of Georgia, as in

Lanfear. The Eleventh Circuit's rejection of this approach to stock drop claims likely abrogates those earlier decisions.

Second, *Lanfear* is a major step toward uniformity among circuit courts on this issue, as it marks the sixth out of 13 circuits to adopt the presumption expressly. By joining the Second, Third, Fifth, Sixth, and Ninth Circuits, the Eleventh Circuit demonstrates the growing acceptance of the presumption and may influence the remaining circuits, none of which have yet rejected the presumption on the merits.

Third, affirming the application of the presumption at the pleading stage is in marked contrast to a recent Sixth Circuit decision to the contrary in *Pfeil v. State Bank and Trust Co.*[3]

The resolution of this circuit split is a developing issue in ERISA litigation, and it is likely to have a significant impact on the viability of ERISA stock drop law suits going forward. It may also eventually lead the United States Supreme Court to consider the application of the *Moench* presumption.

NOTES

1. No. 10-13002, 2012 WL 1580614 (11th Cir. May 8, 2012).
2. 62 F.3d 553 (3d Cir. 1995).
3. 671 F.3d 585 (6th Cir. 2012).