Harvard Law School Forum on
Corporate Governance and Financial Regulation

“Presumption of Prudence” for Fiduciaries in ERISA Litigation

Posted by George T. Conway III, Wachtell, Lipton, Rosen & Katz, on Tuesday, November 15, 2011

Tags: ERISA, Fiduciary duties, Gearren v. McGraw-Hill, In re Citigroup, Prudence, Securities litigation
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Editor's Note: George Conway is partner in the Litigation Department at Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton firm memorandum by Mr. Conway, **John F. Lynch**, and **Bradley R. Wilson**. Another memo about the two court cases described below is available from Schulte Roth & Zabel LLP **here**.

In companion decisions issued recently, the United States Court of Appeals for the Second Circuit has ruled that retirement-plan fiduciaries should have the benefit of a “presumption of prudence” when faced with claims by employees concerning losses on their employer’s stock. The cases are ***In re Citigroup ERISA Litigation, No. 09-3804-CV (2d Cir. Oct. 19, 2011)***, and ***Gearren v. McGraw-Hill Cos., No. 10-792-CV (2d Cir. Oct. 19, 2011)***.

The two cases involved the same basic facts. The retirement plans at issue mandated that employees have as one of their investment options a fund consisting mainly of their employer’s stock — Citigroup in one case, McGraw-Hill in the other. After each company suffered a stock-price decline, plan participants complained that the fiduciaries should have seen the decline coming and either should have eliminated the employer stock fund as an option under the plan, or else sold the company’s stock out of the fund. The plaintiffs claimed that the fiduciaries, by failing to do so, violated their duties of prudence and loyalty under the Employee Retirement Income Security Act.

Seeking to balance the “competing ERISA values of protecting retirement assets and encouraging investment in employer stock,” the Second Circuit followed the lead of four other circuit courts in ruling that where ERISA plans require that plan participants have the option to invest in their employer’s stock, courts must presume that plan fiduciaries acted prudently in preserving that option. This presumption of prudence can be rebutted, but only where circumstances place the company in a “dire situation” that the plan’s sponsors could not have foreseen when they mandated that the employer’s stock be available under the plan. The Second Circuit instructed that fluctuations in the employer’s stock price, even significant downward trends, are not enough; and “direness” must be judged based on the information available to the fiduciary back when divestment of the employer’s stock supposedly should have occurred, not in hindsight based on the size of the later stock drop.

The “dire situation” standard leaves open the possibility that a plan fiduciary might someday be deemed imprudent under ERISA for leaving in place a plan-mandated option for employees to invest in their company’s stock, and the Second Circuit declined to adopt an approach that would have foreclosed that possibility. But the Court made clear that the presumption of prudence is a “substantial shield” for fiduciaries, protecting them from ERISA liability as long as reasonable fiduciaries might disagree on the need to shield employees from future declines in the employer’s stock price.

Beyond claiming imprudence, the plaintiffs in each case accused the fiduciaries of violating ERISA’s duty of loyalty by failing to provide information about the company’s expected future performance. The Second Circuit rejected these claims on the ground that fiduciaries have no duty to dispense investment advice or disclose nonpublic information about employees’ investment options.
