Miller Canfield

Sixth Circuit Clarifies Standards in ERISA Stock Drop Case

February 29, 2012

In a decision that will make it more difficult for ERISA plan fiduciaries to obtain dismissal of breach of fiduciary duty claims on a motion to dismiss, the Sixth Circuit ruled that plan participants do not need to overcome at the pleadings stage the presumption of prudence that applies to a fiduciary's decision to remain invested in employer securities. In *Pfeil v. State Street Bank and Trust Co.*, class action plaintiffs alleged that State Street Bank and Trust, the fiduciary for two General Motors (GM) retirement plans, breached its fiduciary duties by continuing to allow plan participants to invest in GM common stock, even though public information indicated that GM was headed for bankruptcy. The plans at issue were defined contribution plans for salaried and hourly employees, each of which maintained individual accounts for each participant. The plans offered several investment options, including the General Motors Stock Fund. The plan documents provided that the company stock fund "shall be invested exclusively" in GM stock, but also provided that the stock restriction did not apply (a) if there were serious questions regarding GM's short-term viability as a going-concern without resort to bankruptcy proceedings or (b) if there was no possibility in the short-term of recouping substantial proceeds from the sale of stock in bankruptcy proceedings. If either of the conditions were met, then the plan documents directed State Street to divest the plan's holdings in the GM Stock Fund.

On July 15, 2008 GM Chief Executive Rick Wagoner announced that the company needed to implement a "significant" restructuring plan. On November 21, 2008, State Street informed participants that it was suspending further purchases of the GM Common Stock fund. On March 31, 2009, State Street began to sell off the plan's holdings in company stock, a process that was completed on April 24, 2009. GM filed for bankruptcy on June 1, 2009.

State Street filed a motion to dismiss based solely on the allegations in the complaint, which the district court granted. On appeal, the Sixth Circuit first addressed whether dismissal was justified under the presumption of prudence that applies to fiduciaries of Employee Stock Ownership Plans. This presumption holds that a fiduciary's decision to remain invested in employer securities is presumed to be reasonable, but that a plaintiff may rebut the presumption by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision.

Although the Sixth Circuit initially held that the plaintiffs pled sufficient facts to overcome the presumption, the court went on to hold, contrary to the decisions of several other Courts of Appeal, that the presumption of reasonableness is not an additional pleading requirement and does not apply at the motion to dismiss stage. According to the court, the presumption was an evidentiary presumption to be applied to a fully developed record, *i.e.*, after discovery.

Next, the court held that the plaintiffs adequately pled that State Street proximately caused the losses to the plan. The Sixth Circuit explained that State Street was obligated to exercise prudence when designating and monitoring the menu of investment options offered to participants. Therefore, the fact that the participants had authority to reallocate their investments among the fund options did not insulate State Street from liability.

Finally, the Sixth Circuit held that the safe harbor in ERISA §404(c), which provides that a plan trustee "is not liable for any loss caused by any breach which results from the participant's exercise of control over those assets," does not apply at the motion to dismiss stage because it is an affirmative defense that was not raised in the complaint. The court further held that even if the plans satisfied the Department of Labor's regulations to qualify for the safe harbor, §404(c) does not apply because it does not relieve fiduciaries of the responsibility to screen investments. The court explained that because the safe harbor relieves fiduciaries of responsibility for decisions it does not control, it does not apply to

fiduciary decisions – such as the selection of a plan investment option – that the fiduciary does control.

WHAT DOES THIS CASE MEAN FOR FIDUCIARIES?

The Sixth Circuit's ruling in *Pfeil* will make it more difficult to obtain dismissal of an employer "stock drop" case before the parties engage in costly discovery. Because *Pfeil* makes it easier for plan participants and beneficiaries to survive motions to dismiss in comparison to other circuits, plaintiffs may look for a way to bring these stock drop lawsuits in the Sixth Circuit.

Michael Alaimo

Brian Schwartz
schwartz@millercanfield.com