ERISA Litigation

Company stock cases continue to take top billing

SINCE the Enron collapse, plan sponsors and fiduciaries of defined contribution plans have been confronted with many so-called "stock drop" cases alleging that plan sponsors and fiduciaries were imprudent in permitting ESOP and EIAP plan participants to continue to invest in company stock, despite the stock losing significant value in the marketplace. In a favorable recent development, the Second Circuit joined the Third, Fifth, Sixth and Ninth Circuits in adopting the "*Moench* presumption" of prudence in ERISA stock drop cases, which provides for a rebuttable presumption in favor of investment in employer securities for ESOPs.

The *Moench* presumption was formulated in 1995 by the Third Circuit and provides that an ESOP fiduciary who invests plan assets in employer stock "is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." The presumption has since been extended to apply in the EIAP context where a company stock fund is offered as an investment option. The plaintiffs' bar and the Department of Labor have argued strenuously that the legal standard that should apply to a plan's investment in or continued holding of company stock is the generally applicable prudence standard under ERISA section 404. On the other hand, defendant plan sponsors and other plan fiduciaries point out, correctly in our view, that where a plan is designed for the singular purpose of investing in company stock and is maintained in a manner consistent with the rules and regulations established by Congress encouraging the investment in company stock, the plan should stay invested in company stock absent impending collapse of the company. Let's take a closer look at an important recent decision.

The plaintiffs in the Second Circuit's recent decision, *In re: Citigroup ERISA Litigation*, were employees of Citigroup and Citibank N.A. and participated in identical 401(k) plans sponsored by Citigroup. Both Plans mandated that Citigroup common stock was offered as an investment option but participants were free to invest assets within the Citigroup Common Stock Fund and between 20 to 40 other investment options. After a 50% decline in the price of Citigroup common stock following the subprime mortgage crisis, the plans' participants filed a consolidated class action against Citigroup, alleging Citigroup and plan fiduciaries breached their duty of prudence by failing to divest the plans of Citigroup stock due to its poor performance.

In a 2-1 decision, the Second Circuit affirmed the lower court's dismissal of the *Citigroup* complaint and adopted the *Moench* presumption stating that it "provides the best accommodation between the competing ERISA values of protecting retirement assets and encouraging investment in employer stock." The Court maintained that an investment in employer stock would only be overturned for an abuse of discretion. The Court noted that the *Moench* presumption is appropriate absent circumstances placing a company in a "dire situation" that was "objectively unforeseeable by the settlor," and that plan fiduciaries would not be required to override plan terms concerning the investment in employer stock. The Court ruled that proof of a company's impending collapse may not be necessary to establish liability, but did not provide specific guidance as to the circumstances that meet this standard. *Citigroup* also limited the fiduciary duty to investigate the prudence of investment in company stock. Specifically, in the Second Circuit, it is not sufficient for plaintiffs to allege that plan fiduciaries failed to investigate the continued prudence of investing in company stock; rather, they must prove such an investigation "would have led defendants to conclude that [employer stock] was no longer a prudent investment."

While the Second Circuit's adoption of the *Moench* presumption may be characterized as a "win" for plan sponsors wishing to offer employer stock to participants, *Citigroup* does not provide an absolute shield against all allegations of fiduciary misconduct relating to employer stock in the future. There is still significant resistance to the presumption despite the fact that it has not been expressly rejected by any circuit court.

In our view, it is likely that some murkiness and confusion will continue to reign in this area of the law and that the plaintiffs' bar with the encouragement of the Labor Department will continue to bring cases until the application of the *Moench* standard is sorted out by the Supreme Court.

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