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Eleventh Circuit Rules That Home Depot Plan Fiduciaries Did Not Breach Their Duties Related to the Plan's Company Stock Fund: Lanfear v. Home Depot, Inc.

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In *Lanfear v. Home Depot, Inc.*, No. 10-13002 (11th Cir. May 8, 2012), the U.S. Court of Appeals for the Eleventh Circuit joined five other federal circuit courts in adopting a presumption that, in the absence of an abuse of discretion, retirement plan fiduciaries can comply with their duty of prudence when they continue to invest and hold plan assets in the plan's employer stock investment option in compliance with plan directions. Applying that presumption, the court upheld the dismissal of the plaintiffs' claims against the fiduciaries of the Home Depot, Inc. retirement plan.

Background. The *Lanfear* plaintiffs were employees of Home Depot, Inc. ("Home Depot"). Home Depot sponsored a defined contribution employee retirement plan ("the Plan"), which was both an eligible individual account plan and an employee stock option plan under ERISA. The Plan required that its eight investment options include a "Company Stock Fund" ("CSF") invested primarily in shares of Home Depot. The Plan's summary plan description disclosed that the CSF was the riskiest of the Plan's investment options. Although Home Depot's employer matching and direct employer contributions to the Plan had to be invested initially in the CSF, the participants could thereafter transfer those contributions to other Plan funds.

The plaintiffs alleged that the Plan's fiduciaries breached their duties of prudence and loyalty to Plan participants by continuing to hold shares in the CSF even though they knew that the Home Depot stock was probably overpriced, by giving inaccurate information about the CSF, and by not disclosing to Plan participants certain Home Depot misconduct that inflated the Home Depot stock value.

In particular, the plaintiffs asserted that, from 2002 to 2004, Home Depot made widespread improper usage of its vendor-chargeback program in a way that inflated Home Depot's earnings and profit margins. Though this practice was stopped in 2004, the resulting adjustments immediately caused Home Depot's reported earnings to drop, and its stock price soon fell. The inflation of Home Depot's earnings also had led to inaccurate filings of earnings and profits reports with the SEC from 2001 to 2004. In addition, Home Depot disclosed in 2006 that some of its executives had backdated their stock options since 2001. Plaintiffs contended that these instances of misconduct dropped the value of the stock assets in the CSF, such that it was imprudent to purchase or hold so much of the stock. They said further that the Plan fiduciaries knew of non-public information about Home Depot's misconduct but did not disclose it to the participants. The plaintiffs sued for damage to their now-diminished Plan investments, but their complaint was dismissed by the district court. The plaintiffs then appealed to the Eleventh Circuit.

The Court's Decision. The Eleventh Circuit ruled that the Plan fiduciaries breached neither their duty of prudence nor their duty of loyalty to the participants. In reaching its decision on the duty of prudence, the court acknowledged that this fundamental fiduciary duty, as well as the related duty of diversification of plan assets, was in tension with another ERISA statutory provision designed to encourage plans to offer participants the option to invest in their employer's stock, thereby promoting employee ownership. Recognizing that this tension had led to much prior litigation, the court reviewed the decision of the Third Circuit in *Moench v. Robertson*, 62 F.3d 553 (3d 1995), addressing that issue. *Moench* held that a fiduciary is presumed to act prudently when investing in and holding employer stock where the plan directs such investment. However, *Moench* also held that such a presumption can be rebutted by showing that the fiduciary could not reasonably have believed that his continued adherence to the plan's employer stock option directives fulfilled the plan sponsor's expectations of a prudent fiduciary under the circumstances.

Although it adopted the "*Moench* presumption," the Eleventh Circuit did not adopt what some courts have called the "brink of financial collapse" test. That interpretation of *Moench* holds that a participant cannot overcome the presumption of the fiduciary's prudence unless the fiduciary knows that the employer is on the brink of collapse or, as the Eleventh Circuit put it, "peering over the precipice into a financial abyss."

Lanfear does not require such dire circumstances to rebut the presumption. The Eleventh Circuit held that, in order to show that a plan fiduciary has breached his duty where a plan requires company stock to be a plan investment option, a plaintiff must show that the fiduciary could not reasonably have believed the plan sponsor would have intended the fiduciary, under the circumstances then existing, to continue investing in and holding the company's stock. As a result, this test permits something less than "the brink of financial collapse" to require a prudent fiduciary to stop buying or holding company stock. *Lanfear* holds that, if confronted with circumstances that would defeat or substantially impair the purpose of the plan, a prudent fiduciary should deviate from the plan's directives for employer stock investment to the extent necessary to protect the plan's overall purposes.

However, the Eleventh Circuit ruled that, in this particular case, the plaintiffs' complaint failed to plead facts showing that the Plan's fiduciaries were faced with such circumstances.

The court also affirmed the dismissal of the plaintiffs' breach of loyalty claims. Regarding the SEC filings, the court held that these reports and disclosures were not made by Plan fiduciaries but by Home Depot employees acting for the company. Regarding the alleged failure to disclose insider information about the overinflated stock prices, the Eleventh Circuit held that plan fiduciaries are not investment advisors and have no duty to provide plan participants with non-public information affecting the plan sponsor's stock. Further, the court suggested that making such a disclosure to participants would result in a leak of the information outside the company, thereby causing exactly the damage to stock value that the plaintiffs complained of. The court held that, in any event, ERISA did not impose such a duty on plan fiduciaries.

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