StockShield Hedge Offers Path for Fiduciaries Seeking to Satisfy Fifth Third "More Harm Than Good" Standard

Ronald J. Mann
Columbia Law School

Fiduciaries and employees both would agree that the Supreme Court's decision in *Fifth Third Bancorp v Dudenhoeffer* left far too many practical questions unanswered. Perhaps the hardest question is how to understand the "more harm than good" standard that the Court articulated for managing material nonpublic information.

Concerned about the quandary of fiduciaries worried that revealing harmful information might devalue the fund's holding, the *Fifth Third* Court held that a plaintiff seeking to challenge a fiduciary's failure to act must "allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." Specifically, the Court explained, a complaint must be dismissed unless "a prudent fiduciary * * * could not have concluded that [taking action] would do more harm than good to the fund." Two events this spring have brought that particular problem into sharper focus.

The first is the Supreme Court's application of the "more harm than good" standard in *Amgen Inc. v Harris*. The Ninth Circuit in that case found a complaint adequate because it was "quite plausible" that stopping purchases of employee stock would not cause undue harm to plan participants. The Supreme Court disagreed and summarily reversed, explaining that the question is not whether it is "plausible" that taking action will not harm the employees. Quoting its discussion in *Fifth Third* emphatically, the Court explained that the proper question is whether "a prudent fiduciary in the same position 'could not have concluded' that the alternative action 'would do more harm than good.'"

The second is a district court opinion in *Hill v Hill Bros. Construction Co.*. Like *Fifth Third* and *Amgen*, *Hill Bros.* involved an ESOP, but in this case the firm was not publicly traded. Accordingly, the distinction that *Fifth Third* draws between public and nonpublic information is irrelevant; for companies like Hill Brothers, all information is nonpublic. Still, the district court (the federal court in Mississippi) held that the "alternative-action" analysis of *Fifth Third* and *Amgen* applies. Like the plaintiffs in *Fifth Third* and *Amgen*, the strategies identified by the plaintiffs in *Hill Bros.* were stopping purchases of employer stock and disclosing the adverse information. Because both strategies have the potential to harm the price of employer stock that the funds already owns, the Hill Bros. court (like the Amgen Court) found that the employees had failed to identify an appropriate alternate strategy.

Although the decision in *Hill Bros.* favors the fiduciaries in that case, it provides little solace to either employees or fiduciaries. Employees are left with no recourse as fiduciaries stand idly by as employee retirement funds dissipate upon the financial distress of the employer. Fiduciaries, at the same time, face the prospect that whenever such distress occurs – and it is not uncommon – they will have no good way to protect the employees for whose benefit they manage the fund.

The availability of a hedge such as the ESOP Protection Trust becomes critical at that point. Use of that kind of hedge will not cause either of the harms that posed problems for the fiduciaries in *Fifth Third*, *Amgen*, and *Hill Bros.* Because execution of the hedge is a private transaction, the decision of the fiduciaries to use a protective hedge would not come to the attention of market participants and thus would not pose the market risks that disclosure of adverse information or a cessation of routine purchases might cause. On the contrary, the hedge simply protects the employees against the downside risk that their retirement-fund holdings will dissipate if their employer happens to experience hard times. A hedge like the ESOP Protection Trust, then, has the ability to protect both employees and plan fiduciaries.

Indeed, given the mechanical operation of the product, the likelihood that the hedge would protect the employees seems so obvious that fiduciaries well might put themselves at risk if they do ***not*** use such a hedge. Even the largest firms face a distressingly salient risk of financial distress; the average lifespan of Fortune 500 firms has shrunk from 60 years two generations ago to only 18 years. Fiduciaries that do not take action to protect their beneficiaries from that risk have only themselves to blame if disgruntled employees claim after the fact that their inattentiveness amounted to a breach of ERISA's duty of prudence.