Proskauer

Second Circuit Revives Dismissed ERISA Stock-Drop Suit

Employee Benefits & Executive Compensation Blog on **December 27, 2018**

The Second Circuit reinstated a claim for breach of fiduciary duty under ERISA brought by participants in IBM's 401(k) plan who suffered losses from their investment in IBM stock. *Jander v. Retirement Plans Committee of IBM, et al*. 2018 WL 6441116 (2d Cir. Dec. 10, 2018). In so ruling, the Second Circuit became the first circuit court since the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), to allow such a claim to survive a motion to dismiss. According to media reports, this has sparked renewed hope within the ERISA plaintiffs' bar in the viability of these claims. Below, we briefly review the Supreme Court and Circuit Court precedent leading up to the Second Circuit's *IBM* decision, the *IBM*decision itself, and its potential implications going forward.

The Supreme Court's Decisions in *Dudenhoeffer v. Fifth Third* and *Amgen v. Harris*

In *Dudenhoeffer*, a unanimous Supreme Court held that there are no unique pleading standards for employer stock claims under ERISA, but nevertheless provided more rigid criteria for satisfying these standards, particularly in claims alleging that insider fiduciaries breached their fiduciary duties by failing to act on non-public information to prevent losses from investments in allegedly overvalued employer stock. The Supreme Court held that, to satisfy the pleading requirements, the plaintiff must allege an alternative action that the plan fiduciary could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances could not have viewed as more likely to harm the fund than to help it. Three considerations informed the Court's development of this standard: (1) fiduciaries are not required to break the law, (2) disclosures under ERISA could conflict with the letter and objectives of insider trading and other securities laws, and (3) acting on inside information could cause a drop in the stock price and do more harm than good to the stock already held by the plan.

The Supreme Court subsequently confirmed that the *Dudenhoeffer* standard sets a high bar. In *Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016), the Court ruled that the Ninth Circuit erred by permitting a breach of fiduciary duty claim to proceed without first determining whether the complaint contained facts and allegations supporting a claim that removal of the Amgen stock fund was an alternative action that no prudent fiduciary could have concluded would cause more harm than good.

Four Circuit Courts Have Affirmed Judgments Dismissing ERISA Stock-Drop Claims

Following *Amgen*, four circuit courts—the Second, Fifth, Sixth, and Ninth Circuits—had occasion to consider whether a 401(k) plan participant satisfied the *Dudenhoeffer* standard by alleging an alternative action that a plan fiduciary could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances could not have viewed as more likely to harm the fund than to help it. All four circuits concluded that the participants had failed to satisfy this standard and affirmed the dismissal of the claims. In each case, the court held that a prudent fiduciary could have concluded that a premature disclosure of negative company information outside normal corporate channels of communication would do more harm than good to a plan. *Laffen v. Hewlett-Packard Co.*, 721 F. App'x 642, 644–45 (9th Cir. 2018); *Martone v. Robb*, 902 F.3d 519, 526–27 (5th Cir. 2018); *Graham v. Fearon*, 721 F. App'x 429, 437 (6th Cir. 2018); *Saumer v. Cliffs Nat'l Res. Inc.*, 853 F.3d 855, 861 (6th Cir. 2017); *Loeza v. John Does 1-10*, 659 F. App'x 44, 45–46 (2d Cir. 2016); *Whitley v. BP, P.L.C.*, 838 F.3d 523, 529 (5th Cir. 2016); *Rinehart v. Lehman Bros. Holdings Inc.*, 817 F.3d 56, 68 (2d Cir. 2016). The courts reasoned that a prudent fiduciary could have concluded that an unusual disclosure of negative news by a plan fiduciary before the issues had been fully investigated would spook the market into believing that problems at the company were worse than they actually were and thus harm plan participants already invested in the company stock fund. The Ninth Circuit also concluded that public disclosure of allegations that are not yet fully investigated would be inconsistent with the objectives of the securities laws. *In re HP*, 2015 WL 3749565, at *7 (N.D. Cal. June 15, 2015), *aff'd sub. nom Laffen*, 721 F. App'x 642.

The Second Circuit's *IBM* Decision

In *IBM*, the plaintiff alleged that the defendants knew of, and should have disclosed to plan participants, certain accounting irregularities—for which the defendants themselves were allegedly responsible. According to the complaint, the failure to disclose left IBM's stock price artificially inflated and harmed participants when the irregularities were eventually disclosed and the price of the stock declined by more than $12 per share.

The district court had twice dismissed the participants' claim based on its finding that the complaint lacked context-specific allegations as to why a prudent fiduciary could not have concluded that plaintiff's proposed alternatives were more likely to do harm than good and therefore failed to satisfy the *Dudenhoeffer* pleading standard.

On appeal, the Second Circuit reversed and concluded that the plaintiff had pled a plausible claim. The Court first explained that the Supreme Court's *Dudenhoeffer* test was not clear because it initially asked whether a prudent fiduciary in the same circumstances *would* not have viewed an alternative action as more likely to harm the fund than to help it, and then reframed the question as whether a prudent fiduciary *could* not have concluded that the action would do more harm than good by dropping the stock price. According to the Court, the use of the "would not have" phrase considers the conclusions that an "average prudent fiduciary" may reach, and the use of the "could not have" phrase suggests a more restrictive standard requiring consideration of whether "*any* prudent fiduciary" could conclude that the alleged alternative actions would do more harm than good.

The Court found it unnecessary to decide which formulation applies because, in the Court's view, the Complaint's allegations satisfied either standard. According to the Court, the plan participant pled a plausible fiduciary breach claim because: (i) the plan fiduciaries allegedly knew that company stock was artificially inflated; (ii) the defendants were "uniquely situated to fix [the accounting irregularities] inasmuch as they had primary responsibility for the public disclosures that had artificially inflated the stock price to begin with" and disclosure could have been made within IBM's quarterly SEC filings; (iii) the failure to promptly disclose the truth allegedly caused reputational harm to the company that exacerbated the harm to the stock price; (iv) the stock traded on an efficient market and there was thus no need to fear that disclosure would result in an overreaction by the market; and (v) disclosure of the truth was inevitable. Accordingly, the Court reversed the district court's judgment dismissing the complaint and remanded the case for further proceedings.

Proskauer's Perspective

The Second Circuit's ruling in *IBM* contrasts sharply with every other court that has considered this issue, even within the Second Circuit. Perhaps most significantly, the Court's view that disclosure could have occurred within the securities laws' normal reporting regime conflicts with earlier circuit court decisions (including the Second Circuit) clearly holding that public disclosures on behalf of a company, *e.g.*, SEC filings, are made in a corporate, and not fiduciary, capacity and thus are not a basis for ERISA fiduciary liability.

IBM has since petitioned the Circuit for rehearing *en banc*. We are hopeful that the full circuit or, if necessary, the Supreme Court will ultimately reject the approach taken by the panel in *IBM* in much the same way that the Supreme Court ruled in *Amgen* that the Ninth Circuit erred by permitting a similar claim to proceed without first determining whether the complaint contained facts and allegations satisfying the *Dudenhoeffer* standard.

View Original