The Fifth Circuit Emphasizes that Conclusory Statements will not Satisfy the Pleading Standard for Stock Drop Lawsuits

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On September 26, 2016, the Fifth Circuit, in *Whitley v. BP, P.L.C.* ("*Whitley*"), 2016 WL 5387678 (2016), emphasized that conclusory statements will not satisfy the pleading standard for complaints alleging breaches of fiduciary duty related to retirement plans' investment in employer stock (commonly known as stock-drop cases), as established in *Fifth Third v. Dudenhoeffer* ("*Dudenhoeffer*"), 134 S. Ct. 2459 (2014). After *Dudenhoeffer*, plaintiffs in ERISA stock drop cases must plausibly allege an alternative action that the ERISA fiduciary 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. The Supreme Court has also clarified that the *complaint itself* must plausibly allege that a prudent fiduciary in the same position could not have concluded that the alternative action would do more harm than good; a court cannot simply presume that the plaintiff's proposed alternatives would satisfy the *Dudenhoeffer* pleading standard. *Amgen Inc. v. Harris*, 136 S.Ct. 758 (2016).

Whitley involves an employee stock ownership plan ("ESOP") offered to employees of the international oil and gas company BP, P.L.C., ("BP"). BP's 2010 Deepwater Horizon oil spill caused the company's stock to drop significantly in value. Affected participants brought suit, alleging that the plans' fiduciaries breached their fiduciary duty by offering employer stock as an investment option, despite knowing it was artificially inflated. The participants alleged the breach occurred both before the explosion, by BP's misrepresentations regarding its safety improvements and the risk of future accidents, and after the explosion, by BP's misrepresentations concerning the oil spill's magnitude.

The plaintiffs' complaint in *Whitley* presented two alternative actions that the plan fiduciaries could have taken in light of their insider knowledge that would not have violated securities laws: (1) freezing, limiting, or restricting company stock purchases, and (2) disclosing unfavorable information to the public. The plaintiffs alleged that these actions "would not have been more likely to harm the BP Stock Fund than to help it."

After the Fifth Circuit remanded the case for reconsideration in light of *Dudenhoeffer*, the District Court for the Southern District of Texas granted the Whitley plaintiffs' motion to file an amended complaint on the basis that the plaintiffs had plausibly alleged that the defendants had insider

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information and had plausibly alleged two alternative actions that the defendants could have taken that met the *Dudenhoeffer* standard. The district court then certified the defendants' motion for interlocutory appeal of its ruling on the motion, and the Fifth Circuit's recent opinion arose from this appeal. The Department of Labor ("DOL") filed an amicus brief requesting that the Fifth Circuit uphold the district court's decision and arguing that under the specific facts of the case "no reasonable fiduciary could have concluded that refraining from purchasing stock that was inflated due to the fraudulent concealment of safety problems would have caused more harm than good to the plan participants." (Brief for the Secretary of Labor as Amicus Curiae in Support of Plaintiffs-Appellees at 24.) Further, the DOL argued that "although a corrective public disclosure likely would have decreased the value of stock already held by the Plan, a reasonable fiduciary would have understood that such a drop would have eventually occurred anyway once the fraud was revealed… and thus would have acted to stop any further harm to the Plan by refusing to purchase more BP stock until the fraud was disclosed." (*Id.* at 23.) The Securities and Exchange Commission ("SEC") filed a brief coordinated with the DOL, stating that the alternatives proposed by the DOL could be implemented consistent with securities laws. (Brief for the Securities and Exchange Commission as Amicus Curiae in Support of Plaintiffs-Appellees at 7.)

However, unpersuaded by the requests of the DOL and SEC, and the position of the plaintiffs-appellees, the Fifth Circuit found that the plaintiffs' amended complaint was insufficient and remanded the case, under the following rationale:

First, the Fifth Circuit explained that the district court had incorrectly interpreted the *Dudenhoeffer* standard when it stated that "it could not determine, on the basis of the pleadings alone, that no prudent fiduciary would have concluded that [the alternatives] would *do more good than harm*." (*Whitley* at 6.) The Fifth Circuit explained that this is not a statement equivalent to the standard announced by *Dudenhoeffer*, and that under *Dudenhoeffer*, the plaintiff instead "bears the significant burden of proposing an alternative course of action so clearly beneficial that a prudent fiduciary *could not conclude* that it would be more likely to harm the fund than to help it." (*Whitley* at 6.)

Second, the Fifth Circuit held that the plaintiffs had failed to meet this burden, because, aside from conclusory statements that the alternatives "would not have been more likely to harm the [fund] than to help it…. the stockholders do not specifically allege, for each proposed alternative, that a *prudent fiduciary* could not have concluded that the alternatives would do more harm than good, nor do they offer facts that would support such an allegation." (*Id.)* The Fifth Circuit then noted that "it does not seem reasonable to say that a prudent fiduciary at that time could not have concluded that [either of the two proposed alternatives] – both of which would likely lower the stock price — would do more harm than good," and that "[i]n fact, it seems that a prudent fiduciary could very easily conclude that such actions *would* do more harm than good." (*Id.*)

Whitley demonstrates that conclusory statements that no prudent fiduciary would conclude that a course of action would do more harm than good, without specific facts supporting such allegations, will not meet the pleading standard under *Dudenhoeffer*. However, it is still unclear what type of additional facts will be needed to meet that standard. We will continue to monitor these stock drop cases and will update you of any significant developments.

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