Second Circuit Breathes New Life Into Company Stock Litigation

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In offering their own company stock as a plan investment option, retirement plan fiduciaries are subject to the same duty of prudence that governs the selection, retention, and removal of any other investments. Before 2014, litigation against plan fiduciaries that offered their companies' stock as an investment option was relatively commonplace. Some insurers viewed those companies as a particular risk. However, the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S.Ct. 2459 (2014), made it very difficult for plaintiffs in cases challenging the inclusion of company stock to survive early motions to dismiss. As a result, the number of cases filed challenging fiduciary decisions to continue offering company stock as an investment option declined significantly. Many plaintiffs' attorneys began to view these cases as not being worth the time and effort to pursue. This, in turn, has caused some companies to perceive that the risk of offering company stock has largely declined.

Under *Dudenhoeffer*, plaintiffs must satisfy a rigorous two-part test if they allege a fiduciary failed to act on non-public information, by failing, for example, to sell the plan's holdings in the company stock, by refraining from allowing additional purchases, or by disclosing negative information that might cause the stock price to decline. First, a plaintiff must sufficiently plead an alternative action the fiduciary could have taken that would not have violated securities laws (i.e., insider trading rules). Second, plaintiffs must plead facts that show why a prudent fiduciary in that fiduciary's position would ***not*** have viewed the alternative action as more likely to harm the stock fund than help it. This second requirement has proven to be nearly insurmountable for litigants, as courts have dismissed almost every so-called "stock drop" case filed since *Dudenhoeffer*.

The recent decision by the U.S. Court of Appeals for the Second Circuit in *Jander v. Ret. Plans Comm. of IBM*, 910 F.3d 620 (2d Cir. 2018), however, reverses that trend. In *Jander*, the Second

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Circuit Court of Appeals found the plaintiffs' allegations sufficient to meet the heightened *Dudenhoeffer* standard.

The plaintiffs in *Jander* were participants in a retirement plan sponsored by IBM. One of the Plan's investment options was an IBM Company Stock Fund (the "Fund"), which was primarily invested in IBM stock. In October 2014, IBM announced the sale of its microelectronic business division, and a related $2.4 billion write-down of its assets. Plaintiffs alleged that IBM knew this division was struggling financially, but failed to take action to prevent the foreseeable drop in IBM's stock price that occurred once IBM announced the sale of the division. After the announcement, the value of IBM shares fell over 7% in three days.

In their amended complaint, the plaintiffs claimed that IBM could have taken three alternative courses of conduct to mitigate the losses to the Fund. First, they alleged IBM could have made an earlier corrective public disclosure about the true financial health of the microelectronics division. This, they claimed, would have brought IBM stock to its actual value because it was traded in an efficient market. Second, they claimed IBM could have halted all trades of IBM stock by the Fund. And, third, they alleged that IBM could have purchased a hedging product to offset the foreseeable losses from the inevitable announcement of the sale and related write-down. The plaintiffs relied on a number of academic articles and studies to support these allegations.

The district court concluded, however, that the plaintiffs failed to plead the context specific allegations required under the *Dudenhoeffer* standard, and dismissed the case. It held that the plaintiffs did not sufficiently allege that a prudent fiduciary in the defendants' position would not have viewed their proposed alternatives as more likely to harm the Fund than help it.

By the time the case reached the Court of Appeals, plaintiffs had abandoned all but one of the suggested alternative actions that the fiduciaries could have taken. On appeal, they argued only that the fiduciaries could have made early corrective disclosures of the microelectronics division's financial health in the company's regular SEC reporting, or in disclosures to participants.

The Second Circuit concluded that, when drawing all reasonable inferences in the plaintiffs' favor, "several allegations" in the plaintiffs' complaint stated a viable claim. First, it found the plaintiffs sufficiently pled that the Plan's fiduciaries knew the IBM stock was artificially inflated because they knew about the microelectronics division's struggles. Second, it found the fiduciaries could have disclosed information about the microelectronic division's actual financial health through IBM's quarterly SEC filings and normal participant disclosures. Third, it found that Plan fiduciaries could have foreseen that an inevitable disclosure of the microelectronics division's financial struggles would have negative effects on IBM's reputation and value. Fourth, a reasonable fiduciary would not have feared the market would overreact to an early disclosure, because IBM traded in an efficient market and a truthful disclosure would bring the stock to its true value. And, finally, it concluded that fiduciaries knew that disclosure about the struggling division would be inevitable because they were actively working to sell it. The court found this fifth point "particularly important" because this was not a case where the decision was to release the information or not release it. Rather, it was a decision between an early disclosure and an inevitable later disclosure.

Noting that the "standard is plausibility — not likelihood or certainty…," the court held that the plaintiffs had sufficiently pled that no prudent fiduciary in the fiduciaries' position could have

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concluded that an early disclosure would do more harm than good to the Fund. It remanded the case to the district court, where it will proceed past the pleadings stage.

Jander arguably breathes new life into an area of ERISA litigation that many plaintiffs' attorneys had largely abandoned. It is somewhat difficult to reconcile *Jander* with the decisions in other post-*Dudenhoeffer* decisions, in which courts have consistently found that a prudent fiduciary may very reasonably fear an early disclosure would lead to a drop in stock price. *Dudenhoeffer* itself cautioned that courts should consider whether "publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund." *Jander* also went against trend in accepting the argument that disclosure was inevitable, and therefore, should have been made sooner. Other courts have rejected this hypothetical argument finding it insufficient to outweigh the reasonable fear of an adverse effect on the company's stock price.

It is too soon to say whether other courts will follow *Jander* (which is only binding upon courts in the Second Circuit), or, if the courts instead will continue to view *Dudenhoeffer* as presenting a very difficult obstacle for plaintiffs to scale. In all likelihood, plaintiffs' attorneys who may have avoided entering the fray in company stock cases since *Dudenhoeffer* may be emboldened to revisit their approach. Companies that choose to offer their stock as an investment option should act accordingly, and engage in a prudent process of weighing the risks and benefits of doing so.

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