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Supreme Court Remands Outlier Stock Drop Decision

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For many years, courts have wrestled with the standards that apply to a fiduciary's decision to offer stock of the sponsor company as an investment option in the company's 401(k) plan. The struggle arose from two arguably contradictory provisions in ERISA. One provision encouraged companies to allow investments in their company stock through their retirement plan by exempting company stock investments from ERISA's provision requiring that investments normally be diversified. But fiduciaries remained subject to ERISA's general requirement that they act prudently in selecting plan investment options. Eventually, most federal appeals courts concluded that fiduciaries were presumed to have acted prudently in offering company stock as an investment option. Courts came to recognize that, if a fiduciary decides to discontinue offering the company's stock in the plan, it sends a message to the broader market that the stock is overvalued. That, in turn, would typically cause the stock value to decline.

Nearly six years ago, the Supreme Court ("the Court") considered this conundrum in *Fifth Third Bancorp v. Dudenhoeffer* [134 S.Ct. 2459 (2014)]. In that case, the Court abandoned the "presumption of prudence" standard that most courts applied, and held instead that plaintiffs challenging a fiduciary's decision to continue to offer company stock were required to plead a plausible alternative action that fiduciaries could have taken: an action that would have been consistent with the securities laws (i.e., that would not violate insider trading laws), and one that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it. Almost every court that faced the question after *Dudenhoeffer* held that plaintiffs had failed to allege a plausible alternative, and dismissed complaints in these cases.

But in 2018, the Second Circuit Court of Appeals went the other direction in *Jander v. Ret. Plans Comm. of IBM*, 910 F.3d 620 (2d Cir. 2018). The plaintiffs in *Jander* argued that the IBM plan's fiduciaries should have made early corrective disclosures about a troubled IBM division's poor financial health in IBM's regular reporting to the U.S. Securities and Exchange Commission (SEC) or in disclosures to participants. The Second Circuit held that the plaintiffs had sufficiently pled that no prudent fiduciary could have determined that an early disclosure by IBM's fiduciaries would have done more harm than good to IBM's stock. This decision was contrary to decisions in several other courts that addressed that same argument.

On Tuesday, January 14, the Supreme Court did not reach a decision on the merits of the case, but instead it vacated the Second Circuit's opinion and remanded the case to the Court of Appeals to decide whether it will entertain arguments that the parties had not squarely raised in the lower courts. In a concise per curiam decision, the Supreme Court reiterated *Dudenhoeffer's* strict pleading standard, but then shifted its focus to what the Court determined were novel arguments raised by IBM's fiduciaries and the U.S. Government (which presented the views of the SEC and U.S. Department of Labor) in their briefing before the Supreme Court. The Court remanded the case to the Second Circuit to decide whether it would entertain these arguments in the first instance.

In a concurring opinion, Justice Elena Kagan noted that ERISA fiduciaries *might* have a duty to disclose inside information as long as disclosure would not violate securities laws.

Now, the Second Circuit could address these newly raised arguments, or decline to address them (because they were, arguably, not properly raised before it in the first instance); or it could, presumably, remand the case to the district court to consider these arguments that were only fleshed out in briefs filed before the Supreme Court.

Had the Court considered the merits of whether the "early disclosure" allegations satisfied *Dudenhoeffer's* rigorous pleading requirement, it could have breathed new life into, or closed the door on, so-called "stock drop" lawsuits. Instead, it remains to be seen whether plaintiffs that allege that fiduciaries "should have told me sooner" that company stock was overvalued will survive motions to dismiss.

In the meantime, retirement plan fiduciaries who offer employer stock to plan participants should pay attention to the Court's interest in the interplay between ERISA's fiduciary duties and securities laws. It may prove difficult for ERISA fiduciaries to discern when disclosure of inside information would violate the securities laws, and when it would not. By Justice Kagan's reckoning, there are circumstances when disclosure of inside information will not violate securities laws, and in those instances, ERISA fiduciaries might have an affirmative disclosure obligation. The Court did not answer where that line is drawn, leaving for another day (and possibly another court) the determination of whether there is a predicament faced by companies that offer employer stock as a plan investment option — a risk of violating securities laws in disclosing inside information, or alternatively, a risk of breaching their fiduciary duties under ERISA if they do not disclose.

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