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BLOG

Supreme Court Sends Its Latest "Stock Drop" Case Back to the Second Circuit

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In its 2014 decision in *Fifth Third Bancorp v. Dudenhoeffer*, the Supreme Court analyzed how to apply ERISA's fiduciary duties to corporate insiders who oversee company stock funds in ERISA retirement plans – particularly when those fiduciaries have material, non-public information regarding company stock. In setting forth a new pleading standard, the Supreme Court held that an ERISA plaintiff must plausibly allege "an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary . . . would not have viewed as more likely to harm the fund than to help it."

In subsequent stock drop cases, most courts applied the *Dudenhoeffer* pleading standard strictly. And, when the Ninth Circuit in *Amgen Inc. v. Harris* appeared to apply the standard too loosely, the Supreme Court summarily reversed the decision, holding that the Ninth Circuit failed to adequately scrutinize the plaintiffs' pleadings.

As a result, many ERISA experts were surprised in 2018 by the Second Circuit's decision in *Retirement Plans Committee of IBM v. Jander*. In that case, the Second Circuit concluded that the *Dudenhoeffer* pleading standard was met when the plaintiff merely pleaded that IBM fiduciaries should have disclosed irregularities with respect to IBM stock earlier because no prudent fiduciary in their position could have concluded that earlier disclosure would do more harm than good.

When the Supreme Court agreed to review the *Jander* case, many thought that it would provide the Supreme Court with another opportunity—as in *Amgen*—to clarify how strictly to apply the *Dudenhoeffer* pleading standard. However, on January 14th, the Supreme Court somewhat surprisingly remanded the case back to the Second Circuit.

According to the Supreme Court, the fiduciaries of the ESOP at issue in *Jander* and the Solicitor General (in its amicus curiae or "friend of the court" brief presenting the views of the Securities and Exchange Commission, as well as the Department of Labor) did not focus their Supreme Court arguments on whether the "more harm than good" pleading standard can be satisfied by generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time. Instead, they focused their arguments primarily upon other matters:

1. The fiduciaries argued that ERISA imposes no duty on an ESOP fiduciary to act on inside information; and
2. The government argued that an ERISA-based duty to disclose inside information that is not otherwise required to be disclosed by the securities laws would conflict with the objectives of federal securities laws.

The Supreme Court responded by remanding the case to the Second Circuit because the Court had said in its original *Dudenhoeffer* decision that the views of the SEC might "well be relevant" to applying ERISA's duty of prudence in this context and now felt that the Second Circuit should have an opportunity to entertain the parties' arguments in the first instance.

In a concurring opinion, Justice Gorsuch offered two additional observations:

1. The essence of the plaintiff-participants' claim is that the IBM fiduciaries should have used their positions as corporate insiders to cause IBM to make an SEC-regulated disclosure, but "run-of-the-mill" ERISA fiduciaries cannot order corporate disclosures on behalf of their companies. Further, according to Justice Gorsuch, because ERISA fiduciaries are liable only for actions taken while acting as a fiduciary, it would be odd to hold the same fiduciaries liable for alternative actions that they could have taken only in some other capacity.
2. Justice Gorsuch also asserted that, under *Dudenhoeffer*, a plaintiff's ability to identify a helpful action that the defendant *could* have taken consistent with the securities laws is a *necessary* condition to an ERISA suit but not necessarily a *sufficient* condition to suit, because otherwise, a case could proceed anytime a plaintiff is able to conjure a hypothetical helpful action that would've been consistent with the securities laws. (A separate concurring opinion by Justice Kagan that was joined by Justice Ginsburg suggested that merely identifying an alternative course of action that would not do more harm than good was sufficient to satisfy *Dudenhoeffer*'s pleading standard.)

It is possible that the Second Circuit may not, in fact, entertain the additional arguments of the SEC and of the IBM fiduciaries. Justice Kagan's concurring opinion noted that if the arguments were not properly preserved on appeal, the Second Circuit "may of course determine that under its usual rules of waiver or forfeiture, it will not consider those arguments." If the Second Circuit does not address these arguments in *Jander* upon remand, the arguments seem destined to reappear in subsequent stock drop cases, making another stop before the Supreme Court all but certain.

Until then, Winston attorneys are ready to help fiduciaries analyze techniques to address and minimize their ERISA liability exposure with respect to company stock funds.

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