

January 23, 2020

## U.S. Supreme Court Vacates and Remands ERISA Stock-Drop Suit

### Introduction

On January 14, 2020, the U.S. Supreme Court issued a *per curiam* order in *Retirement Plans Committee of IBM v. Jander*<sup>1</sup> (“Jander”), a closely watched case regarding the pleading standard for corporate stock-drop and disclosure claims under the Employee Retirement Income Security Act (“ERISA”). The Court vacated the Second Circuit’s decision below and remanded for further proceedings, but otherwise declined to address the merits of the case. The Supreme Court’s remand order instead directs the Second Circuit to consider whether to address additional arguments concerning the interaction between the securities laws and ERISA that were raised for the first time in briefing before the Supreme Court. Although the Supreme Court’s decision results in no change to existing law, the remand order nevertheless highlights important issues that defendants in ERISA stock-drop actions should be aware of and should consider when litigating similar cases in the future.

The case arrived at the Supreme Court to resolve a circuit split on the application of the Supreme Court’s decision in *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014). In *Dudenhoeffer*, the Supreme Court held that, to state a claim for breach of the duty of prudence under ERISA on the basis of a failure to act on inside information, a complaint 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 in the same circumstances would not have viewed as more likely to harm the fund than to help it.<sup>2</sup>

Circuit courts have split on whether, under *Dudenhoeffer*, a complaint states a viable duty-of-prudence claim when it alleges that ERISA plan fiduciaries should have caused earlier disclosures of adverse inside information in their possession about the company. In *Jander*, the Second Circuit held that such allegations, on the facts of that case, were sufficient to state a claim under *Dudenhoeffer*, while the Fifth, Sixth, and Ninth Circuits have found similar allegations insufficient.<sup>3</sup>

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<sup>1</sup> No. 18-1165, slip op. (U.S. Jan. 14, 2020).

<sup>2</sup> 573 U.S. at 428.

<sup>3</sup> See *Martone v. Robb*, 902 F.3d 519, 526–27 (5th Cir. 2018); *Laffen v. Hewlett-Packard Co.*, 721 F. App’x 642, 644–45 (9th Cir. 2018); *Graham v. Fearon*, 721 F. App’x 429, 437–38 (6th Cir. 2018); *Saumer v. Cliffs Nat’l Res. Inc.*, 853 F.3d 855, 861–62 (6th Cir. 2017); *Whitley v. BP, P.L.C.*, 838 F.3d 523, 529 (5th Cir. 2016).

### **Jander's Factual and Procedural Background**

*Jander* was brought by participants in IBM's retirement plan who invested in IBM's stock through an employee stock ownership plan ("ESOP").<sup>4</sup> The participants alleged that IBM publicly overstated the value of its microelectronics business at a time when the defendants knew that its value was impaired. The truth was allegedly revealed when, on October 20, 2014, IBM announced that (i) it would pay another company \$1.5 billion in exchange for that company agreeing to purchase the microelectronics business, and (ii) IBM would record a \$4.7 billion impairment charge, reflecting in part the impaired value of that business. IBM also separately disclosed disappointing third-quarter financial results. The company's stock price dropped by approximately 17% following these announcements.

A federal securities complaint was filed in the Southern District of New York on April 1, 2015, alleging that IBM and several of its executives violated Section 10(b) of the Securities Exchange Act and Rule 10b-5 by failing to disclose the truth about the value of the microelectronics business earlier. That complaint was dismissed by the district court on the grounds that plaintiffs failed to adequately plead scienter as required under the Private Securities Litigation Reform Act ("PSLRA").<sup>5</sup> That decision was not appealed.

*Jander* was filed on May 15, 2015, in the Southern District of New York against IBM's Retirement Plans Committee and certain members of IBM's senior management who administered the ESOP. As relevant to the appeal, the complaint alleged that the defendants violated their duty of prudence under ERISA by failing to cause IBM to publicly disclose known problems in the microelectronics business earlier through ordinary-course corporate disclosure channels, such as Forms 10-K and 10-Q. Plaintiffs also alleged that disclosure was inevitable as a result of due diligence being performed by prospective buyers on the microelectronics business, and that earlier disclosure would have mitigated harm to the fund because prolonged concealment would tend to increase the eventual stock drop.

The district court granted the defendants' motion to dismiss, finding that plaintiffs failed to satisfy *Dudenhoeffer's* pleading standard.<sup>6</sup> The Second Circuit reversed, holding that the complaint plausibly alleged that a prudent fiduciary in the defendants' position could not have concluded that issuing an earlier disclosure regarding the condition of the microelectronics business would do more harm than good. Because the complaint alleged that disclosure of adverse information would inevitably occur during due diligence in connection with an impending sale, non-disclosure was "no longer a realistic point of comparison" for evaluating the actions of a prudent fiduciary under the circumstances.<sup>7</sup> The court also

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<sup>4</sup> ESOPs "invest[] primarily in the stock of the company that employs the plan participants." *Dudenhoeffer*, 573 U.S. at 412.

<sup>5</sup> See *Int'l Ass'n of Heat v. Int'l Bus. Machs. Corp.*, 205 F. Supp. 3d 527, 537 (S.D.N.Y. 2016).

<sup>6</sup> *Jander v. Ret. Plans Comm. of IBM*, 272 F. Supp. 3d 444, 449 (S.D.N.Y. 2017).

<sup>7</sup> *Jander v. Ret. Plans Comm. of IBM*, 910 F.3d 620, 630 (2d Cir. 2018).

concluded that the district court erred in disregarding the allegations in the complaint that the harm from non-disclosure would grow over time.

### **The Supreme Court Vacates and Remands**

The U.S. Supreme Court granted *certiorari* on June 3, 2019, and held oral argument on November 6, 2019. On January 14, 2020, in a *per curiam* order, the Supreme Court vacated and remanded the Second Circuit's decision without addressing the merits of the case.

The Court noted that the question presented in *Jander* initially was whether the complaint plausibly alleged, as required by *Dudenhoeffer*, an alternative action “that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it,” and “whether *Dudenhoeffer*'s ‘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.”<sup>8</sup> Yet it pointed out that, before the Supreme Court, both the petitioners and the Government, which appeared as *amicus curiae* to present the views of the Securities and Exchange Commission and the Department of Labor, “focused their arguments primarily upon other matters.”<sup>9</sup>

In particular, the Court observed that petitioners argued that “ERISA imposes no duty on an ESOP fiduciary to act on inside information,” while the Government argued that requiring an ESOP fiduciary to publicly disclose inside information when the securities laws do not require such a disclosure would conflict with the objectives of those laws. These issues had not been presented to or addressed by the lower courts in *Jander*, and the Court concluded that the Second Circuit should have the opportunity to decide whether to address these issues in the first instance.<sup>10</sup>

Justices Kagan and Gorsuch issued concurring opinions, in which they signaled divergent views on how these questions should be resolved on remand.

Justice Kagan, in an opinion joined by Justice Ginsburg, wrote separately to offer “two further notes.”<sup>11</sup> First, she observed that the Second Circuit was free to determine, pursuant to its usual rules of waiver or forfeiture, that the new arguments raised in the Supreme Court could not be considered on remand.<sup>12</sup> Second, she wrote to express the view that *Dudenhoeffer* “makes clear” that an ESOP fiduciary does, at

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<sup>8</sup> *Jander*, slip op. at 2 (quoting *Dudenhoeffer*, 573 U.S. at 428).

<sup>9</sup> *Id.* at 2–3.

<sup>10</sup> *Id.* at 3.

<sup>11</sup> *Id.* at 1 (Kagan, J., concurring).

<sup>12</sup> *Id.*

times, have a duty to act on inside information.<sup>13</sup> Justice Kagan observed that under *Dudenhoeffer*, “a fiduciary can have no obligation to take actions ‘violat[ing] the securities laws’ or ‘conflict[ing]’ with their ‘requirements’ or ‘objectives,’” but that “when an action does not so conflict, it might fall within an ESOP fiduciary’s duty—even if the securities laws do not require it.”<sup>14</sup>

Justice Gorsuch issued a separate concurring opinion, suggesting that the issues on remand should be resolved in favor of the defendants.

Justice Gorsuch noted that requiring early disclosure by ESOP fiduciaries would require those fiduciaries to act “in their capacities as corporate officers, not ERISA fiduciaries,” in order to make “special disclosure[s]” for the benefit of an ERISA plan, which is not something that “[r]un-of-the-mill ERISA fiduciaries” can do.<sup>15</sup> This would impose a higher duty on plan fiduciaries who have the authority to make or order corporate disclosures—typically senior-level executives—than is otherwise imposed by ERISA. He reasoned that, 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 action[s] they] could have taken’ *only* in some other capacity.”<sup>16</sup> He also disagreed with Justice Kagan’s view that the arguments presented by the petitioners and the Government conflicted with *Dudenhoeffer*, which was silent on the resolution of these arguments, and thus did not foreclose them.<sup>17</sup> He noted that remand “would be pointless if the arguments . . . were already foreclosed by *Dudenhoeffer*.”<sup>18</sup>

### Implications of the Supreme Court’s Decision

The Supreme Court’s decision leaves in place the *Dudenhoeffer* standard, which places a heavy burden on plaintiffs pleading duty-of-prudence claims in ERISA stock-drop cases. The *per curiam* order, by its terms, does not change existing law.

Nevertheless, the remand order highlights arguments available to defendants in ERISA stock-drop actions where plaintiffs allege that defendants were required to act on the basis of inside information. The Supreme Court left unresolved both whether ERISA fiduciaries are ever required to act on the basis of inside information to benefit an ERISA plan, and whether *Dudenhoeffer* requires ERISA fiduciaries to cause disclosures that are not otherwise required by the federal securities laws. The concurring opinions by

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<sup>13</sup> *Id.* at 1–2.

<sup>14</sup> *Id.* at 2.

<sup>15</sup> *Id.* at 1 (Gorsuch, J., concurring).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 2–3.

<sup>18</sup> *Id.* at 2.

Justices Kagan and Gorsuch highlight different ways future litigants may present these arguments under *Dudenhoeffer* to advocate for different results.

The views expressed in the concurring opinions also have significant implications for corporations and counsel responsible for making SEC-regulated disclosures. In particular, Justice Kagan's suggestion that ERISA fiduciaries may have disclosure obligations beyond those required by the securities laws would, if accepted, create considerable practical challenges and introduce significant uncertainty in the law. In addition to the comprehensive securities laws and regulations governing all SEC-reporting companies, disclosures would also be subject to additional *ad hoc* judgments concerning whether special disclosures are necessary based on whether they would be more likely to harm than help the company's ERISA plan. It remains unexplained in Justice Kagan's concurring opinion how an obligation to make special disclosures solely to financially benefit an ERISA plan is consistent with the "requirements" or "objectives" of the securities laws, which impose no such requirement.

The Supreme Court's decision also suggests that, in light of the potential for a deepening circuit split, companies may want to consider whether to limit the appointment of corporate officers with disclosure duties and other employees with inside information as ERISA fiduciaries. Until the law in this area is clarified, serving in a dual role may subject such individuals to litigation in which they may have personal liability, and increase the cost of litigation insurance.

We will continue to monitor and update you on these developments in 2020.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Susanna M. Buerger  
+1-212-373-3553  
[sbuerger@paulweiss.com](mailto:sbuerger@paulweiss.com)

William A. Clareman  
+1-212-373-3248  
[wclareman@paulweiss.com](mailto:wclareman@paulweiss.com)

Lewis R. Clayton  
+1-212-373-3215  
[lclayton@paulweiss.com](mailto:lclayton@paulweiss.com)

Andrew J. Ehrlich  
+1-212-373-3166  
[aehrlich@paulweiss.com](mailto:aehrlich@paulweiss.com)

Daniel J. Kramer  
+1-212-373-3020  
[dkramer@paulweiss.com](mailto:dkramer@paulweiss.com)

Richard A. Rosen  
+1-212-373-3305  
[rrosen@paulweiss.com](mailto:rrosen@paulweiss.com)

Audra J. Soloway  
+1-212-373-3289  
[asoloway@paulweiss.com](mailto:asoloway@paulweiss.com)

*Associates Alison R. Benedon and Kimberly Francis contributed to this Client Memorandum.*