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2ND CIRCUIT REVIVES IBM STOCK-DROP CASE

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In a rare victory for plaintiffs in stock-drop litigation, the 2nd US Circuit Court of Appeals has reversed the dismissal of a case alleging imprudence by fiduciaries for IBM's employee stock ownership plan (ESOP), potentially creating a narrow path for other imprudence claims. In *Jander v. Retirement Plans Committee of IBM*, the court ruled that the plaintiffs plausibly alleged that the fiduciaries acted imprudently by not disclosing that IBM's microelectronics division, which the company was trying to sell, was overvalued. The decision revives the case but doesn't address a central question raised by the plaintiffs about the correct pleading standard in these cases. The decision also deviates from other circuit rulings on a key issue in stock-drop cases — whether a company's public disclosures are ERISA fiduciary acts.

Pleading standard for imprudence claims. The Supreme Court's 2014 decision in *Fifth Third Bancorp v. Dudenhoeffer* set the pleading standard for imprudence claims based on inside information. To survive a motion to dismiss, plaintiffs must propose an alternative course of action (for example, disclosing the information or halting trades in the fund) and plausibly allege that a prudent fiduciary in the defendant's position could not have concluded that the proposed action would do more harm than good to the fund. This "more harm than good" standard has proved difficult to meet. Since *Dudenhoeffer*, most cases have never made it past the motion-to-dismiss stage. The district court in the IBM case granted the defendants' motion to dismiss for failing to meet this pleading standard.

What does *Dudenhoeffer* require? In their appeal, the plaintiffs challenged how the district court (and other courts) applied the *Dudenhoeffer* standard. They argued that requiring plaintiffs to allege that no prudent fiduciary could have viewed an alternative action as more harmful than helpful is too heavy a burden. Instead, the standard should be what the average prudent fiduciary would do under the circumstances. The *Dudenhoeffer* decision is unclear on this point. Other courts have considered the distinction, but the Supreme Court has yet to clarify which reading is correct. The 2nd Circuit also sidestepped this question in this case, finding that the plaintiffs' claim was sufficient to survive a motion to dismiss under even the stricter standard.

Plaintiffs met the stricter pleading standard. The plaintiffs alleged IBM could have disclosed the inflated stock price in its routine quarterly SEC filings. Early disclosure, the plaintiffs argued, would have corrected the stock price — but only by the amount the stock was overvalued — and protected management's reputation and IBM's long-term prospects as an investment. The court's acceptance of this allegation is notable because it deviates from other circuit court decisions (including other 2nd Circuit decisions) holding that executives responsible for making a company's public disclosures do so in a corporate, not ERISA fiduciary, capacity.

The 2nd Circuit found another allegation particularly important — that disclosure was inevitable because IBM was trying to sell its microelectronics business. In other stock-drop cases, the more-harm-than-good standard considers whether fiduciaries should have disclosed the inside information at all. When disclosure is inevitable, as the plaintiffs alleged in this case, the question becomes whether earlier disclosure would have been more harmful than helpful. The court acknowledged "it is far more plausible that a prudent fiduciary would prefer to limit the effects of the stock's artificial inflation on the ESOP's beneficiaries through prompt disclosure."

Impact of ruling. IBM in December petitioned the 2nd Circuit for a rehearing, noting that the decision is inconsistent with other 2nd Circuit (and other circuit) decisions on SEC disclosures made in a corporate capacity, but the 2nd Circuit denied the petition. IBM plans to appeal the decision to the Supreme Court. If the decision stands, it could lead to more stock-drop litigation in the 2nd Circuit.

RELATED RESOURCES

- *Jander v. Retirement Plans Comm. of IBM* (2d Cir. Dec. 10, 2018)
- *Fifth Third Bancorp v. Dudenhoeffer* (U.S. June 25, 2014)