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Kathryn J. Kennedy
UIC School of Law, kkenned@uic.edu

DIVIDING THE PLAUSIBLE SHEEP FROM THE MERITLESS GOATS: THE FATE OF STOCK DROP LITIGATION

Kathryn J. Kennedy

The Employee Retirement Income Security Act of 1974 ("ERISA") provides federal oversight over employee benefit plans, specifically employee stock ownership plans ("ESOPs") in which participants' and beneficiaries' retirement savings are in the form of employer stock. It imposes stringent fiduciary duties, especially for individuals or entities that purchase, hold, and sell plan assets, including the duties of prudence, loyalty, and diversification of plan assets. In encouraging the formation of ESOPs, Congress exempts them from the fiduciary duty of diversification and the fiduciary duty of prudence to the extent it requires diversification. As the value of publicly traded employer stock held within an ESOP can fluctuate with the market, federal courts have grappled with the question as to whether ESOP fiduciaries can be held liable under ERISA, regarding its duty of prudence, for investing solely or primarily in employer stock when the statute and the terms of the ESOP provide that the primary purpose of the plan is to invest in employer stock. The Third Circuit in 1995 in the case of Moench v. Robertson afforded the ESOP fiduciary to the "presumption" at the pleading stage, that it satisfied ERISA's fiduciary duties absent a showing of extraordinary changed circumstances that demonstrate investing in employer stock was no longer prudent. The majority of circuit courts adopted the Moench presumption in stock drop litigation, where plaintiffs sued the ESOP fiduciary for purchasing or for failing to sell employer stock that had dropped significantly in value. In 2014, the Supreme Court in the Fifth Third Bancorp v. Dudenhoeffer decision negated the use of such a presumption. Instead, it set forth a two-part pleading requirement to be used in stock drop litigation in order to withstand a motion to dismiss: (1) in the case of a claim for breach of fiduciary duty of prudence based on publicly available information, the plaintiffs must allege "special circumstances" as to why the ESOP fiduciary should not relied on the stock's market price as being reliable or (2) if instead the claim was based on non-public inside information, the plaintiffs must allege an alternative course of action, consistent with

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Professor of Law, University of Illinois Chicago School of Law. Juris Doctorate, Northwestern University School of Law, 1980. My sincere thanks to my research assistant Marc Daou for his excellent support in this endeavor.

securities law, that a prudent ESOP fiduciary should have taken after it concluded that it would not have done more harm than good to the plan's fund. In subsequent litigation, this two-part pleading standard has proven to be too high a hurdle for the plaintiffs' bar. The 2018 case Jander v. Retirement Plans Committee of IBM, however, provided a ray of hope for the plaintiffs' bar in surviving a motion of dismiss based on the fiduciary's insider information. The plaintiffs survived a motion to dismiss by alleging in that a prudent fiduciary could not have concluded that an earlier disclosure of IBM's "undisclosed troubles" in one of its businesses would do more harm than good, as the disclosure was inevitable and the decrease in the value of the employer stock would continue over time. Because most other circuits have rejected the use of this "inevitable" theory to satisfy the Dudenhoffer standard, the U.S. Supreme Court granted certiorari in Jander. The Supreme Court, however, declined to comment on the arguments raised by the defendants and the federal government in its amicus brief as the Second Circuit had not addressed them. Instead, it simply remanded the case back to the Second Circuit, which, in turn, affirmed its prior holding. Thus, the Supreme Court's "more harm than good" Dudenhoeffer standard continues to be a major hurdle for plaintiffs in stock drop litigation. This Article traces the history of stock drop litigation and offers recommendations for ESOP fiduciaries to avoid future litigation.

I. Introduction

In lawsuits brought under the Employee Retirement Income Security Act of 1974 ("ERISA") alleging breaches of fiduciary duty concerning the selection of the plan's investments, most claims relate to the underperformance of the assets selected by the plan trustee (e.g., as compared to their peers or certain benchmarks) or to the fees assessed against the investment funds offered (e.g., share classes).[1] When employer stock is offered in the menu of investments for a defined contribution plan, however, an alternate issue arises: the *prudence* of offering and/or holding employer stock as a plan investment option. The issue arises in one of two contexts, both referred to as the "stock drop" cases: where (1) there is a dramatic drop in value in company stock due to a single event affecting the company or the market, which the plaintiffs allege should have been anticipated; or (2) there has been a long, slow decline in value, in which case, the plaintiffs claim the stock should have been removed at an earlier time from the plan's investment menu.[2]

1. *See* George S. Mellman & Geoffrey T. Sanzenbacher, *401(k) Lawsuits: What Are the Causes and Consequences?*, CTR. FOR RET. RSCH. AT B.C. 1 (May 2018), https://crr.bc.edu/wp-content/uploads/2018/04/IB_18-8.pdf.

2. This Article is limited to companies offering employer stock that is publicly traded on a recognizable stock exchange. It does not address the pleading necessary to withstand a breach of fiduciary duty of prudence claim in the context of a private company ESOP.

Experience in the ERISA litigation context demonstrates that there is a surge in litigation during and immediately following economic downturns. For example, following the 2000–02 stock market downturn, there was considerable litigation against defendant ERISA fiduciaries who invested plan assets in employer stock.[3] Similarly, in the aftermath of the 2008 financial crisis, Bloomberg BNA reported a greater share of ERISA lawsuits filed in 2008 and 2009 (which involved mostly investment fee lawsuits) than in other years between 2006 and 2017.[4] Thus, one would not have been surprised to see a surge in stock drop litigation during 2020 and 2021, in light of the economic turmoil caused by the spread of the COVID-19 virus worldwide. This, however, has not been the case. The United States has not seen corporate events that typically trigger stock drop litigation.[5] Nevertheless, plan fiduciaries should be proactive in avoiding or at least mitigating future stock drop litigation.

As plan fiduciaries offering employer stock as a plan investment option may also be officers, board members, and/or top executives of the employer, their inside knowledge about the value of the company stock may also raise insider information concerns.[6] This raises federal

3. *See, e.g.*, Leigh Jones, *A "Perfect Storm" for Pension Suits?*, NAT'L L.J., Dec. 13, 2004, LexisNexis; Brett Nelson, *Open Season on 401(k)s*, FORBES, Nov. 25, 2002, at 62 ("Lawyers have filed 115 suits against 35 companies claiming employees' 401(k) plans got shafted."); *see also* Brief for Securities Industry and Financial Markets Association in Support of Petitioners at 47, Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014) (No. 12-751) (noting that there were over 250 cases between 1997 and June 30, 2013, filed by participants in defined contribution plans which invested in employer stock).

4. *See* the table of ERISA Cases on Inappropriate Investments, Excessive Fees, and/or Self-Dealing in Retirement Accounts, 2006-2018 (as of January 26, 2018), Bloomberg Bureau of National Affairs (BNA) *ERISA Litigation Tracker*. Rachel Fried, *ERISA Litigation Surging—Focus on Fees*, COVINGTON (Jul. 16, 2018), https://www.insidecompensation.com/2018/07/16/erisa-litigation-surging-focus-on-fees/; *see also* Mellman & Sanzenbacher, *supra* note 1.

5. *See* Aaron M. Cunningham, *COVID-19 has not slowed ERISA legal activity*, PENSIONS & INVESTMENTS (Aug. 18, 2020, 1:58 PM), https://www.pionline.com/interactive/covid-19-has-not-slowed-erisa-legal-activity (indicating that a considerable amount of ERISA litigation during this time involved the level of fees assessed against investments and services offered under a defined contribution plan).

6. The Securities Exchange Act of 1934 ("Exchange Act"), Pub. L. No. 73-291, (codified as 15 U.S.C. §§ 78a et seq.), regulates transactions of securities in the secondary market, after issue, to ensure financial transparency and to prevent fraud. It is administered by the Securities and Exchange Commission ("SEC"). Insider trading is a violation of Exchange Act § 10(b), which forbids the use of "any manipulative or deceptive device or contrivance" in securities transactions. A violation of insider trading occurs when a person buys or sell securities with knowledge of material nonpublic information in breach of a duty of trust that is owed to the issuer

securities law issues,[7] as well as ERISA issues, in deciding whether to discontinue offering company stock in the plan or to disclose inside information to the public that the stock is undervalued.

After the Supreme Court's 2014 decision in *Fifth Third Bancorp v. Dudenhoeffer*,[8] plaintiffs have faced an uphill battle in stock drop litigation. The Second Circuit's 2018 decision in *Jander v. Ret. Plans Comm. of IBM* offered stock-drop plaintiffs a glimmer of hope.[9] Under a new theory—referred to as the "inevitable disclosure" theory—a prudent fiduciary would be required to make *earlier* disclosure of the insider information regarding the value of the stock if the disclosure of such information would have been inevitable.[10] In a unanimous decision in 2020, the Supreme Court vacated the order of the Second Circuit and remanded it to consider the thoughts of the Securities and Exchange Commission ("SEC") in its decision as to whether ERISA requires a plan fiduciary either to refrain from making a planned trade or to disclose inside information possibly in conflict with federal securities law.[11]

This Article examines the history and trends in stock drop litigation, especially in light of the Supreme Court's decisions in *Dudenhoeffer*[12] and *Jander*.[13] It will also discuss whether the appointment of an independent fiduciary would help insulate the employer from stock-drop litigation. It concludes with recommendations as to how ESOP fiduciaries and employers can continue to withstand stock drop litigation in the aftermath of the *Jander*[14] decision. See Section VII of this Article as to how lower courts have reacted in light of the *Jander* decision.

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of the securities or to the shareholders of such issuer or to any other person who is the source of the material nonpublic information. Persons found in violation of insider trading face civil enforcement action by the SEC, as well as criminal prosecution by the Department of Justice ("DOJ"). *See* O'Neil v. Marriott Corp., 538 F. Supp. 1026 (D. Md. 1982) (involving trustees of the ESOP who had knowledge of insider information who were sued due to their failure to act on the basis of insider information to the detriment of the plan participants). The view of both DOJ and the SEC is that public, swift disclosure of all material nonpublic information is required by the securities law. Particularly, the SEC stated that disclosure of material nonpublic information only to the ESOP participants would violate Regulation FD of the 1934 Act. *See* 17 C.F.R. § 243.100 (2021).

7. *See* 15 U.S.C. § 78u-1.
8. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014).
9. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620 (2d Cir. 2018).
10. *See id.* at 630.
11. *See* Ret. Plans Comm. of IBM v. Jander, 140 S. Ct. 592, 594–95 (2020).
12. *See Dudenhoeffer*, 573 U.S. at 412, 430.
13. *See Jander*, 140 S. Ct. at 594–95.
14. *See id.*

II. Language of ERISA and Its Legislative Intent

Congress passed ERISA in 1974,[15] resulting in comprehensive changes for all qualified employee benefits plans. The legislative history indicates that ERISA was enacted to protect participants' rights under employee benefit plans, and to provide employers with a uniform set of federal standards regarding conduct, responsibility, and obligations under such plans.[16] ERISA is both a labor statute (influencing the payment of compensation), as well as a tax statute which imposes tax requirements on *qualified* pension and profit-sharing retirement plans as they provide tax shelters for retirement savings.[17] For-profit employer are eligible to sponsor pension and profit-sharing retirement plans *qualified* under IRC §401(a), which deliver favorable tax consequences for employers and employees alike. In contrast, other type of employers (e.g., governmental employers, church employers, public schools, and other non-profits and charitable organizations) are eligible to sponsor retirement plans such as an IRC §457 plan (an eligible deferred compensation plan) or an IRC §403(b) plan, which are subject to less onerous Code requirements than qualified retirement plans.

Retirement plans come in two forms: defined contribution plans and defined benefit plans. A defined contribution plan is one that provides for an individual account for each participant and benefits are to

15. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in various sections of Titles 26 and 29 U.S.C.). ERISA's labor provisions were codified in Title 29 of the U.S.C., whereas the related tax provisions of the Internal Revenue Code were codified in Title 26 of the U.S.C. All section references in this article are to ERISA section numbers and the Department of Labor ("DOL") regulations thereunder, unless otherwise indicated.

16. *See* S. REP. NO. 93-127, at 35 (1973), as *reprinted in* 1974 U.S.C.C.A.N. 4838, 4871 (noting the Senate version of enforcement provisions as intended to "provide both the Secretary and participants and beneficiaries with broad remedies for redressing or preventing violations of [ERISA]"); H.R. REP. NO. 93-533, at 17 (1973), as *reprinted in* 1974 U.S.C.C.A.N. 4639 (describing House version in identical terms, as quoted by the Supreme Court in Varity Corp. v. Howe, 516 U.S. 489, 512 (1996)). For a detailed history of the events leading up to the passage of ERISA, see James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683 (2001).

17. A retirement plan may be "qualified" under the requirements of 26 U.S.C. § 401(a) in order to secure the following preferential tax benefits: the plan participant is not taxed on his/her vested and secure benefit under the plan until such benefit is actually distributed; the plan sponsor's contribution to the plan is deductible at the time of contributions within certain prescribed limits; and earning on the plan assets accumulate tax-free until the earnings are distributed in the form of a benefit. 26 U.S.C. §§ 402(a), 404.

be based solely on the value of the account.[18] In contrast, a defined benefit plan is any plan that is not a defined contribution plan; it promises benefits to be paid at a given normal retirement age in an annuity form of payment.[19] A participant's account balance under a defined contribution plan may reflect annual employer and employee contributions, forfeitures,[20] and investment earnings and losses during the participant's period of participation. As such, it is not guaranteed to provide certain benefits upon distribution as the value of the assets will fluctuate and affect the account balance.[21]

Retirement plans can also be described in a variety of other forms: pension plans which are designed to provide retirement income, profit sharing plans which are designed to provide for savings which can be used for retirement, and stock bonus plans which are defined contribution plans where the benefits are distributable in employer stock.[22] Generally, stock bonus plans are comparable to profit sharing plans, except that once it is designated as a stock bonus plan, it becomes subject to certain tax requirements applicable only to stock bonus plans.[23] An employee stock ownership plan ("ESOP") may be a stock bonus plan, or a stock bonus plan and a money purchase plan.[24] An ESOP is a retirement plan "designed to invest primarily in" employer stock.[25] The most

18. 29 U.S.C. § 1002(34); 26 U.S.C. § 414(i).

19. 29 U.S.C. § 1002(35); 26 U.S.C. § 414(j).

20. A retirement plan may impose a vesting schedule on the portion of the employee's benefit that is funded by the employer's contribution. *See* 29 U.S.C. § 1053(a)(2); and 26 U.S.C. § 411(a)(2). For example, the employee must have at least five years of service upon termination of employment in order to retain the employer provided benefit; termination of employment prior to the five years results to a total forfeiture of the employer provided benefit. The benefit funded through employee contributions are always vested and not subject to a forfeiture under the terms of the plan. *See* 29 U.S.C. § 1053(a)(1); and 26 U.S.C. § 411(a)(1).

21. *Types of Retirement Plans*, U.S. DEP'T OF LABOR, https://www.dol.gov/general/topic/retirement/typesofplans (last visited Nov. 2, 2021).

22. 26 C.F.R. § 1.401-1(b)(1)(i)–(iii) (2020).

23. 29 U.S.C. § 1107(d)(6)(A); 26 U.S.C. § 4975(e)(7), the ESOP must satisfy the put option requirement in 26 U.S.C. § 409(h); the distribution requirements of 26 U.S.C. § 409(o); the allocation restrictions of 26 U.S.C. § 409(n), if applicable; and the voting rights requirements of 26 U.S.C. § 409(e). According to the Plan Sponsor Council of America's 63rd Annual Survey of Profit Sharing and 401(k) Plans, 15% of plans permit employer stock as an investment option for both participant and company contributions, in contrast to 4% of plans that limit access to employer contributions only. On average, 22% of total plan assets are invested in employer stock. *See 63rd Annual Survey Report*, PLAN SPONSOR COUNCIL OF AM. (2020), https://www.psca.org/research/401k/63rdAR.

24. 26 U.S.C. § 4975(e)(7).

25. *Id.* § 4975(e)(7)(A).

common type of defined contribution plan is the 401(k) plan,[26] in which employer stock may be offered as one of the investment options. Many 401(k) plans designate that the employer stock fund is maintained by the plan as an ESOP.[27] The main difference between a 401(k) ESOP and a non-401(k) ESOP is that the latter is invested exclusively in employer stock (plus a minimal amount of cash for liquidity purposes).[28] These types of plans qualify as eligible individual account plans, which are exempt from ERISA's duty of diversification, as discussed below.

Critics of ESOPs focus on their riskiness.[29] ESOPs allow employees to concentrate their retirement contributions in one asset—the employer's stock—and thus, employees must entirely rely on the employer for both their salaries and retirement benefits.[30] Proponents of ESOPs, however, argue: that ESOP employers are more likely to have a secondary retirement plan (e.g., a 401(k) plan); ESOP employers contribute fifty- to one-hundred- percent more to ESOPs than non-ESOP employers; most of the ESOP contributions are from the employer and not the employee; coverage under an ESOP is more expansive, especially for younger and lower income employees; and the ESOPs tend to have higher rates of return than 401(k) plans.[31]

While the primary goal of an ESOP is to provide employees with an ownership interest in their employer, ESOPs additionally serve several corporate objectives. ESOPs can be used in corporate financing to result in greater cash flow.[32] The ESOP may borrow money and engage in transactions with related parties to purchase employer stock that otherwise would have been void under the prohibited transaction provisions of ERISA and the Internal Revenue Code ("IRC").[33] A leveraged

26. Kate Ashford & Benjamin Curry, *What Is A Defined Contribution Plan?*, FORBES ADVISOR (Feb. 22, 2021, 9:56 PM), https://www.forbes.com/advisor/retirement/defined-contribution-plan/.

27. Brief for Securities Industry and Financial Markets Association in Support of Petitioners at 8, Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014) (No. 12-751).

28. The ESOP Ass'n, *ESOPs vs. 401(k)s*, ESOP, https://esopassociation.org/articles/esops-vs-401k (last visited Oct. 18, 2021).

29. *See* Corey Rosen, *Do ESOPs Need Reform? A Look at What the Data Tell Us*, 147 TAX NOTES 1465, 1466 (2015).

30. *See id.*

31. *See id.* at 1466–67.

32. *Id.* at 1468.

33. Under 29 U.S.C. § 1106(a)(1)(A), a plan fiduciary is prohibited from engaging in a transaction, directly or indirectly, that involves the sale of property (including employer securities) between the plan and a party in interest (which includes the employer). Similar rules appear in 26 U.S.C. § 4975(c)(1)(A).

ESOP is a technique of corporate finance whereby the employee stock ownership trust purchases stock from the employer using the proceeds of a loan made by a financial institution.[34] The employer guarantees the loan and its contributions to the trust are used as proceeds to retire the loan.[35] This thereby results in equity ownership in the hands of the covered plan participants.[36] It also allows the corporation to repay the loan with tax deductible contributions within the limits of IRC § 404(a)(9).[37] Privately held companies can avoid the cost of a public stock offering and nevertheless get shares of the company in the hands of its employees via an ESOP.[38] The shares can be purchased from the company, existing shareholders, or both.[39]

Title I of ERISA created a federal cause of action for a variety of claims, including a breach of fiduciary duty.[40] On its face, the statute creates a cause of action for the Secretary of Labor, or a participant, beneficiary, or fiduciary for liability for breach of fiduciary duty.[41] This makes the faulting fiduciary personally liable to make good to the plan such losses due to the breach and/or to restore to the plan any profits the fiduciary made through the use of plan assets, as well as other equitable or remedial relief that the court deems appropriate.[42]

There are several ways in which a plan fiduciary can breach his/her fiduciary duty. The term "fiduciaries duties" under ERISA and the IRC is actually a misnomer, as the duties that a plan fiduciary should perform are prescribed by the plan and/or trust documents or by law.[43] In reality, ERISA's and the IRC's "fiduciaries duties" are standards of care by which a plan fiduciary will be judged in performing his/her actual duties under the plan and/or trust or by law.[44]

34. Adam Hayes, *Leveraged Employee Stock Ownership Plan (LESOP)*, INVESTOPEDIA (Apr. 1, 2021), https://www.investopedia.com/terms/l/lesop.asp.

35. *Id.*

36. *See* Rev. R. 79-122, 1979-1 C.B. 204.

37. I.R.C. 404(a)(9) (2014); *Tax Advantages for Business Planning*, THE ESOP ASS'N (2018), https://esopoassociation.org/sites/tea-master/files/2019-12/esop-brief-3-final.pdf.

38. *How an Employee Stock Ownership Plan (ESOP) Works*, NAT'L CTR. FOR EMP. OWNERSHIP (Aug. 24, 2020), https://www.nceo.org/articles/esop-employee-stock-ownership-plan.

39. *Id.*

40. 29 U.S.C. §§ 1103, 1109 [§ 1109 titled Liability for breach of fiduciary duty].

41. 29 U.S.C. § 1109(a).

42. *Id.*

43. *See Fiduciary Responsibilities*, U.S. DEP'T OF LABOR, https://www.dol.gov/general/topic/retirement/fiduciaryresp (last visited Nov. 2, 2021).

44. *See id.*

ERISA and the IRC impose three duties on all fiduciaries of covered employee benefit plans:

- *Exclusive Benefit Rule of ERISA § 404(a)(1)(A)*: A fiduciary is to discharge his/her duties with respect to the plan *solely* in the interest of the participants and beneficiaries.[45] As such, the plan fiduciary is to act for the exclusive purpose of providing benefits to participants and their beneficiaries and of defraying reasonable expenses in administering the plan.[46]
- *Prudent Person Rule of ERISA § 404(a)(1)(B)*: A fiduciary is to discharge his/her duties with the care, skill, *prudence*, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would act.[47] As ERISA presumes a greater level of expertise for any plan fiduciary,[48] it results in a stricter standard than the common law "prudent person" standard.[49] Under this stricter standard of care, the Department of Labor's ("DOL") regulations state that a plan fiduciary charged with investing the plan assets has satisfied such standard if: (1) he/she gives appropriate consideration to the facts and circumstances that, given the scope of such investment duties, the fiduciary knows or should have known are relevant to the particular investment or investment course of action involved, including the role that the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which he/she has investment duties; and (2) has acted accordingly.[50]
- *In Accordance with the Terms of the Plan of ERISA § 404(a)(1)(D)*: A fiduciary is to discharge his/her duties in accordance with the documents and instruments governing the plan insofar as they are consistent with the terms of ERISA and the IRC.[51]

The Supreme Court views the above fiduciary standards as "strict standards of trustee conduct... derived from the common law of trusts—most prominently, a standard of loyalty and a standard of care."[52] As such, courts have viewed–such standards as "the highest known to the law."[53]

45. 29 U.S.C. § 1104(a)(1)(A) (1994 & Supp. V. 1999) (emphasis added).
46. *Id.*
47. *Id.* § 1104(a)(1)(B) (emphasis added).
48. *See* Brief of Law Professors as Amici Curiae in Support of the Respondents at 4, Retirement Plans Committee of IBM v. Jander, 140 S. Ct. 592 (2020).
49. *See id.*
50. 29 C.F.R. § 2550.404a-1(a) to (b)(1)(i)-(ii) (2021).
51. 29 U.S.C. § 1104(a)(1)(D); 26 U.S.C. § 4975.
52. Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570 (1985).
53. Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

In the context of a fiduciary who is the *trustee* with respect to the plan assets, ERISA and the IRC impose two additional fiduciary duties:

- *Diversification of ERISA § 404(a)(1)(C)*: A fiduciary is to discharge his/her investment duties by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the facts and circumstances it is clearly prudent not to do so.[54]
- *Indicia of Ownership ERISA §404(b):* A plan trustee may not maintain the indicia of ownership of plan assets outside the jurisdiction of the U.S. district courts.[55]

As ERISA originally envisioned the promulgation of ESOPs, it modified the above fiduciary standards by stating that the above diversification requirement and the above prudence requirement (to the extent it requires diversification) are not violated due to the acquisition or holding of employer stock.[56] ESOP fiduciaries are charged with maximizing participants' benefits by investing "primarily in qualifying employer securities,"[57] in lieu of investing in assets other than employer stock. The legislative intent was to encourage the use of ESOPs:

> INTENT OF CONGRESS CONCERNING EMPLOYEE STOCK OWNERSHIP PLANS. The Congress, in a series of laws [including ERISA] and this Act has made clear its interest in encouraging [ESOPs] as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat [ESOPs] as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.[58]

The DOL's advisory letters are instructional to ESOP fiduciaries, requiring adherence to procedural prudence (i.e., mandating that ESOP fiduciaries hire independent financial and legal counsel and that their decisions consider only the interests of the plan participants and their beneficiaries).[59] Thus, in the context of ESOPs, a paradox has developed

54. 29 U.S.C. § 1104(a)(1)(C).
55. 29 U.S.C. § 1104(b).
56. 29 U.S.C. § 1104(a)(2).
57. 29 U.S.C. § 1107(d)(6)(A).
58. Tax Reform Act of 1976, Pub. L. No. 94-455 § 803(h), 90 Stat. 1520, 1590.
59. *See* Informational Letter from the U.S. Dep't of Labor to Gareth W. Cook (Sept. 12, 1983) (on file with author); Information Letter from the U.S. Dep't of Labor to Charles R. Smith (Nov. 23, 1984) (reprinted in 12 PENS. & BEN. REP. 52);

for plan fiduciaries: when is it no longer prudent to hold or acquire employer stock in the face of the terms of the plan which require the plan investments be held "primarily in" company stock as permitted by the terms of ERISA? The statute clearly permitted the plan fiduciary to deviate from ERISA's diversification requirement,[60] but can its prudence requirement be reconciled with the express terms of the statute permitting plan investments to be held "primarily in" company stock,[61] particularly, if the terms of the plan document required the fiduciary to do so? Balancing the issue of prudence with the stated purpose of an ESOP to invest primarily in employer securities is further complicated if the plan fiduciary is a member of the employer's board of directors, one of its top executives, or other "corporate insiders." Those plan fiduciaries may be privy to company inside information, making it more difficult to wear "two hats"—one as plan fiduciary and one as corporate officer or insider. As such, plan fiduciaries who choose to act on their inside information while fulfilling their fiduciary obligations risk running afoul of federal securities law.[62]

III. Typical Breach of Fiduciary Duty of Prudence

As noted earlier, ERISA lawsuits alleging breach of fiduciary duty of prudence concerning the selection of the plan's investments have generally related to the underperformance of the assets selected by the plan trustee or to the fees assessed against the investment funds offered.[63] Thus, the author felt an understanding of what needs to be alleged in these types of fiduciary duty of prudence claims, in order to survive a motion to dismiss, would be illustrative. The reader then can contrast it with the pleading requirements in stock drop litigation, as now required by *Dudenhoeffer*.

Federal Rule of Civil Procedure ("FRCP") 8(a)(2) mandates that a complaint present "a short and plain statement of the claim showing that the pleader is entitled to relief."[64] To survive a motion to dismiss

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Information Letter from the U.S. Dep't of Labor to Wilson H. Ellis, Jr. (July 30, 1985) (reprinted in 12 PENS. & BEN. REP. 1182).

60. *See generally*, Pamela Perun, *Employee Stock Ownership Plans: A Status Report*, URBAN INST. (June 2010), https://www.urban.org/sites/default/files/publication/62196/309563-Employee-Stock-Ownership-Plans.PDF.

61. *See id.* at 1.

62. Securities Exchange Act of 1934 § 16, 15 U.S.C. § 78p.

63. *See* Mellman & Sanzenbacher, *supra* note 1.

64. FED. R. CIV. P. 8(a)(2).

under FRCP 12(b)(6), "a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'"[65] In this regard, courts are allowed to draw reasonable inferences from the alleged facts to determine that the defendant is responsible for the misconduct.[66] Mere conclusions and a "formulaic recitation of the elements of a cause of action," however, will not suffice.[67] See Section VII for a further discussion of the two seminal cases that refine this pleading standard.

In the context of a claim under ERISA for breach of fiduciary duty of prudence, the plaintiff "must make a prima facie showing that the defendant acted as a fiduciary, breached its fiduciary duties, and thereby caused a loss to the [p]lan."[68] While the fiduciary duty of prudence requires the fiduciary to discharge his or her duties with respect to the plan "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims,"[69] courts focus "on the process by which [the fiduciary] makes its decisions rather than the results of those decisions."[70] In evaluating whether to grant a motion to dismiss a claim for breach of the fiduciary duty of prudence, FRCP 8(a)(2) does not require the plaintiff to plead "specific facts" for the courts to ascertain how the defendant's conduct was unlawful.[71] Instead, the complaint may allege facts "indirectly showing unlawful behavior, so long as the facts pled give the defendant fair notice of what the claim is and the grounds upon which it rests,"[72] and "allows the court to draw the reasonable inference that the plaintiff is entitled to relief."[73] As explained by the Third Circuit, "a claimant does not have to set out in detail the facts upon which he bases his claim. The pleading standard

65. Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007)); FED. R. CIV. P. 12(b)(6).
66. *Id.* at 678.
67. Twombly, 550 U.S. at 555.
68. Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 594 (8th Cir. 2009) (citing Pegram v. Herdrich, 530 U.S. 211, 225–26 (2000)).
69. 29 U.S.C. § 1104(a)(1)(B).
70. *Braden*, 588 F.3d at 595.
71. *Id.*
72. *Id.* (quoting *Twombly*, 550 U.S. at 555).
73. *Id.* (citing Ashcroft v. Iqbal 556 U.S. 662, 678 (2009) (internal quotations omitted)).

is not akin to a 'probability requirement;' to survive a motion to dismiss, a complaint merely has to state a 'plausible claim for relief.'"[74]

In the past two decades, there has been significant litigation in which 401(k) plan holders have alleged that their plan fiduciaries breached their fiduciary duty by paying "excessive fees" to financial advisors and for inadequately disclosing such fees to plan holders.[75] As to the questions about whether the plan fiduciary acted prudently, the courts have generally sided with the plan fiduciary.[76] As defendants in such fee litigation file pre-discovery motions to dismiss, the courts have been reluctant to rule in the defendants' favor as the plaintiffs had yet to have a chance to discover facts to prove their claim.[77]

Braden v. Wal-Mart Stores is illustrative as to how courts have viewed whether the plaintiff has alleged a sufficient breach of fiduciary duty claim to survive a motion to dismiss.[78] In *Braden*, the Eighth Circuit reversed the district court's motion to dismiss, which had held that the plaintiffs failed to state a claim for violation of the fiduciary duties of prudence as to the investment options included in the plan.[79] In *Braden*, Braden, a Wal-Mart plan participant, brought a class action breach of fiduciary claim against Wal-Mart and various executives—who served as plan fiduciaries under Wal-Mart's 401(k) plan—on the grounds that the defendants breached their fiduciary duties of prudence and loyalty in evaluating the investment options included under the plan.[80] The plan had over $10 billion in assets and offered ten mutual funds, a common/collective trust, Wal-Mart common stock, and a stable value fund.[81] Due to the size of the plan's assets, the complaint noted that

74. Covington v. Int'l Ass'n Approved Basketball Offs., 710 F.3d 114, 118 (3d Cir. 2013) (internal citations omitted).

75. *See* Jon Chambers, *ERISA Litigation in Defined Contribution Plans: Background, History, Current Status and Risk Management Techniques*, SageView Advisory Group (Mar. 2021), https://static.fmgsuite.com/media/documents/6e6a6ef1-6f5f-445d-a83b-d7bd1b15f4f6.pdf. Beginning in 2006, the St. Louis law firm of Schlichter Bogard & Denton filed eighteen class action lawsuits against many of America's largest companies (e.g., Boeing, Caterpillar, Deere, and Bechtel). Such lawsuits generally alleged that the plan fiduciaries breached their ERISA fiduciary duties by allowing recordkeepers to levy excessive fees and to provide imprudent investment options. One of the most significant of these excessive fee lawsuits was *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009).

76. *See, e.g.*, Divane v. Northwestern Univ., 953 F.3d 980, 983 (7th Cir. 2020).

77. *See id.*

78. *See* Braden v. Wal-Mart Stores, Inc., 588 F.3d 585 (8th Cir. 2009).

79. *Id.* at 598. This was the first major appellate court ruling in favor of the plaintiffs in excessive fee litigation cases.

80. *Id.* at 589–90.

81. *Id.* at 589.

retail shares were made available to individual participants, instead of institutional shares of mutual funds, which would have been significantly cheaper.[82] The complaint alleged that the investment options included in the plan by Wal-Mart's Retirement Plans Committee (the plan's named fiduciary and the entity responsible for the operation, investment policy, and plan administration) charged excessive fees, which were not justified by greater returns on the investments as most of them underperformed lower-cost alternatives.[83] It also alleged that the appellees did not alter the plan's investment options even though most underperformed the market indices that they were intended to track.[84]

The district court dismissed this part of the complaint as it did not address the *process* by which the fiduciaries made their decisions.[85] The Eighth Circuit disagreed, holding that it was reasonable to infer from the plaintiffs' allegations that the plan offered a limited menu of investment options, despite the availability of better funds, which if such allegations were true, would indicate that the process by which they selected and managed the funds was "tainted by failure of effort, competence, or loyalty."[86] Hence, the plaintiffs had in fact stated a claim for breach of fiduciary duty.[87] While the appellees could have selected such funds with higher fees for legitimate reasons (e.g., potential for greater return, lower financial risk, or more services rendered), FRCP 8(a)(2) does not require the plaintiff to rebut the defendants' lawful explanations.[88] The Eighth Circuit also noted that "ERISA plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery commences."[89] As such, plaintiffs need only offer sufficient factual allegations that he or she is not "merely engaged in a fishing expedition or strike suit;"[90] otherwise, the "remedial scheme of the statute will fail, and the crucial rights secured by ERISA will suffer."[91]

82. *Id.* at 590.
83. *Id.*
84. *Id.* at 596.
85. *Id.*
86. *Id.*
87. *Id.* at 589.
88. *Id.* at 596.
89. *Id.* at 598.
90. *Id*.
91. *Id.* The case eventually settled for $13.5 million in December 2011.

In contrast, the Seventh Circuit's decision in *Divane v. Northwestern University* is at odds with the opinion of other circuits as to what must be alleged in an excessive fee case to survive a motion to dismiss.[92] The beneficiaries of Northwestern University's Retirement Plan and Voluntary Savings Plans (as the university sponsored §403(b) plans) sued Northwestern University and the plan's investment committee for breaching its ERISA fiduciary duty by offering a range of investment options that were too broad and by offering investment options that charged excessive fees.[93] Plaintiffs also argued that the employer's use of multiple recordkeepers hindered their ability to take advantage of economies of scale, resulting in excessive recordkeeping fees.[94] The district court granted the defendants' motion to dismiss and the Seventh Circuit affirmed.[95] Prior to October of 2016, the Retirement Plan offered 242 investment options and the Voluntary Savings Plan offered 187 investment options, including mutual funds and insurance company annuities. By October 2016, it offered a mere forty investment options.[96]

The Seventh Circuit addressed two distinct claims made by the plaintiffs in their complaint that the defendants breached their fiduciary duty of prudence: (1) that the defendants offered retail-class investment funds even though identical institutional class funds with lower management fees were available to the plan due to its size and (2) that the defendants failed to monitor investment performance and reduce the plan's recordkeeping costs.[97] As to the first issue, the court held that, regardless of whether retail share funds were made available, the plaintiffs had other low-cost index funds available to them in the plan's menu, "eliminating any claim that plan participants were forced to stomach an unappetizing menu."[98] According to the court, the plaintiffs could have avoided excessive fees and investment underperformance by simply choosing from "hundreds of other options within a multi-tiered offering system."[99] The court distinguished the facts of this case

92. Hughes v. Northwestern Univ., 953 F.3d 980 (7th Cir. 2020), *reh'g en banc denied*, 2020 U.S. App. LEXIS 14992 (May 11, 2020), 2021 U.S. LEXIS 3583 (July 2, 2021), *cert. granted sub nom*; *see also* Hecker v. Deere & Co., 556 F.3d 575 (7th Cir. 2009), *reh'g denied*, 569 F.3d 708 (7th Cir. 2009).

93. Divane v. Northwestern Univ., 953 F.3d 980, 983 (7th Cir. 2020).

94. *Id.* at 984.

95. *Id.* at 985, 994.

96. *Id.* at 984.

97. *Id.* at 984–85 (these main issues have dominated excessive fee litigation over the past two decades.).

98. *Id.* at 991.

99. *Id.* at 988.

with the *Braden* decision where "the investment plan included a 'relatively limited menu of funds'—ten—which 'were chosen to benefit the trustee at the expense of the participants.'"[100] Thus, such allegations failed to state a breach of fiduciary duty.[101]

As to the second issue, the court noted that ERISA does not require a fiduciary to embrace a certain type of recordkeeping arrangement and that the plaintiffs failed to show that a flat-fee recordkeeping rate would have benefited them.[102] Thus, there was no ERISA violation with Northwestern's recordkeeping arrangement.[103]

On July 2, 2021, the Supreme Court granted a petition for writ of certiorari to review the Seventh Circuit's decision in *Divane v. Northwestern University*, 953 F.3d 980 (7th Cir. 2020), *cert. granted sub nom., Hughes v. Northwestern*, No. 19-1401 (July 2, 2021) ("Hughes").[104]

The 401(k) and 403(b) communities will be playing close attention to the *Hughes* case as to what needs to be pleaded in a claim for breach of fiduciary duty in managing a 401(k) plan's investment fees and investment options.[105]

The author instructs the reader to reread this section *after* he or she reads the Supreme Court's decision in *Dudenhoeffer*, in which it frames the new standard of pleadings for stock drop litigation.[106] It provides a striking contrast as to the plaintiff's pleading hurdles in a breach

100. *Id.* at 991 (quoting Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 596 (8th Cir. 2009)).

101. *Id.*

102. *Id.* at 990 (citing Loomis v. Exelon Corp., 658 F.3d 667, 672–73 (7th Cir. 2011)).

103. *Id.* at 991.

104. In October 2020, the Supreme Court requested that the Acting Solicitor General file a brief in the case. Acting Solicitor General Elizabeth B. Prelogar advised the Supreme Court to hear the Northwestern case as it implicates a circuit split and involves important and recurring issues regarding retirement assets in ERISA-covered plans. *See* Brief for the United States as Amicus Curiae, *Hughes v. Northwestern Univ.*, 141 S. Ct. 2882 (2021) (No. 19-1401), 2021 WL 2144249. The split in the circuits pits the Seventh Circuit's decision in *Hughes* against *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585 (8th Cir. 2009) and *Sweda v. Univ. Pa.*, 923 F.3d 320 (3d Cir. 2019).

105. The ESOP community is also cautioned to pay attention to the result of the Supreme Court decision, as the result will have implications for them in non-stock drop ESOP litigation involving breaches of fiduciary duty of prudence and loyalty. *See* Rick Pearl, *Thinking ESOPs: What the Supreme Court's Decision in a 401(k) Fee Case Could Mean for ESOPs*, FAEGRE DRINKER (July 12, 2021), https://www.faegredrinker.com/en/insights/publications/2021/7/what-supreme-court-decision-in-401k-fee-case-could-mean-for-esops. As of this Article's publication, the Supreme Court has not yet released their decision in *Hughes*.

106. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 428–30 (2014).

of fiduciary duty of prudence claims in stock drop litigation involving ESOPs, as opposed to a breach of fiduciary duty of prudence claims involving 401(k) non-ESOP plans.[107]

IV. Historical Perspective of Stock Drop Litigation

The Third Circuit's 1995 holding in *Moench v. Robertson* was instrumental in shaping stock drop litigation from 1995 through 2014.[108] That case involved Statewide Bancorp ("Statewide"), a bank holding company, and its two wholly owned subsidiaries, The First National Bank of Toms River ("FNBTR") and The First National Bank of New Jersey/Salem County.[109] Statewide established and maintained an ESOP for its employees, which was administered by an ESOP Committee.[110] Members of Statewide's board of directors made up the ESOP Committee.[111] As it began to experience financial difficulties, the market value of the Statewide common stock fell from \$18.25 to \$9.50 from July to December of 1989.[112] During the next year, the price fell even "more precipitously" to \$6 per share in July 1990, to \$2.25 per share in December 1990, and finally, to less than twenty-five cents per share in May 1991.[113] The Office of the Comptroller of the Currency ("OCC") informed the Statewide board in July 1989 of violations of law and

107. *See* Schweitzer v. Inv. Comm. of the Phillips 66 Sav. Plan, 960 F.3d 190 (5th Cir. 2020) and Stegemann v. Gannett Co., 970 F.3d 465 (4th Cir. 2020), which are referred to by practitioners as "single-stock" ERISA cases. These cases involved large employers who spin off a portion of their business to a new company and as a result of the spin-off, transfer a portion of its 401(k) plan for the transferred employees to the new company. The transferred 401(k) assets include employer stock of the original employer (referred to as the single-stock fund), not employer stock of the current employer. This issue is very common in the "pension de-risking" context in which large companies are spinning off assets and liabilities in order to reduce the large pension obligations posted on their books. If the fiduciaries of the new employer's plan do not divest themselves of the single-stock fund, they risk litigation on the grounds that it is not prudent to hold such funds in the wake of their declining value, nor did they diversify the investments of the plan so as to minimize the risk of loss. Both the Fifth and Fourth Circuits held that these single-stock funds were not employer securities under the new employer's plan and thus could subject the fiduciaries of the new employer's plan to litigation on the grounds that holding such funds could be imprudent because of the risk inherent in failing to diversify, which does not implicate *Dudenhoeffer*.

108. Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995), *cert. denied*, 516 U.S. 1115 (1996).

109. *Id.* at 557.

110. *Id.*

111. *Id.* at 558.

112. *Id.* at 557.

113. *Id.*

regulation across its subsidiary banks and recommended that it improve policies and procedures.[114] A second report in March of 1990 revealed "lack of depth and quality of management, unsafe and unsound credit practices, the resulting rapid deterioration in the quality of the loan portfolio, unreliable regulatory and management reports on loans, the inadequacy of the Allowance for Loan and Lease Losses, and the adverse impact of asset quality upon earnings and capital adequacy."[115] By May 1991, the Federal Deposit Insurance Corporation ("FDIC") took control of FNBTR, and, a day later, Statewide filed for bankruptcy.[116]

The terms of the Trust Agreement noted that the ESOP Committee had responsibility and control over the plan's administration, including establishing any investment guidelines, which would be communicated to the Trustee.[117] In turn, the Trustee had exclusive responsibility over the control and management of plan assets.[118] The terms of the plan provided that the Trustee would invest all contributions in employer stock, except for a portion of the contributions that could serve as a reserve to pay administrative expenses and cash distributions.[119] During the relevant time period in which the Statewide stock was nosediving, it was unclear from the record as to whether the ESOP Committee met to discuss whether action should be taken.[120] In June of 1990, investors filed a class action securities fraud suit against Statewide and certain of its directors, which was eventually settled for $3.2 million.[121] In early 1991, the Trustee ceased investing in Statewide stock, and instead, placed all ESOP assets into money market accounts.[122] By November of 1992, Moench, a former Statewide employee who participated in the ESOP, filed a class action claim against the members of the ESOP Committee for breach of fiduciary duty under ERISA Sections 404 and 409.[123]

In the district court, Moench filed a motion for partial summary judgment declaring that each of the Committee members were

114. *Id.*
115. *Id.*
116. *Id.*
117. *Id.* at 558.
118. *Id.*
119. *Id.*
120. *Id.* at 559.
121. *Id.*
122. *Id.*
123. *Id.*

fiduciaries under ERISA.[124] The Committee admitted that its members were fiduciaries, but it filed a cross-motion to dismiss the complaint on the grounds it did not breach ERISA's fiduciary duties.[125] The district court issued an opinion, granting both motions.[126] Finding that the Committee had no discretion under the terms of the plan to invest in anything but Statewide common stock, the district court held that Moench failed to establish that the Committee's actions in purchasing employer stock was in violation of the plan or ERISA.[127] It noted too that the ESOP plan was a "capital accumulation" plan, one that did not provide for a guaranteed benefit at retirement.[128] Thus, the nature of the ESOP plan envisions that the value of the employees' benefits will fluctuate as the employer stock varies.[129] Moench filed an appeal to the Third Circuit.

The Third Circuit began by noting that it faced a "difficult question": can ESOP fiduciaries be held liable under ERISA for investing solely in employer stock when both the statute and the terms of the ESOP provided that the primary purpose of the plan is to invest in employer's securities?[130] Before addressing the breach of fiduciary claims, the court addressed the Committee's argument that its members were not ERISA fiduciaries with respect to investments, but rather, the Trustee or Statewide was such a fiduciary.[131] As the Committee failed to raise this argument at the district court level, the Third Circuit addressed the issue of whether the Committee's failure constituted a waiver of the argument.[132] The court concluded that the Committee's representations to the district court, along with the arguments seen in its brief, conceded that they were fiduciaries with respect to how to invest the ESOP assets.[133] The Third Circuit then addressed three specific issues:

- Was the Committee in fact required by the terms of the plan to invest the plan assets in employer stock?
- If the answer was yes, was the Committee limited by the essence of the ESOP to invest solely in employer stock?

124. *Id.* at 560.
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.* at 556.
131. *Id.* at 561.
132. *Id.*
133. *Id.* at 562.

- If the plan did require the Committee to invest in employer stock, did ERISA's fiduciary duties require it to disregard the terms of the plan and to diversify the plan assets?[134]

In resolving the first issue, the court noted that the district court had deferred to the Committee's interpretation of the plan due to the application of the *Firestone Tire & Rubber Co. v. Bruch* standard of judicial review.[135] In *Firestone*, the Supreme Court had to determine the appropriate judicial standard of review in the context of the plan fiduciary interpreting the terms of the plan in order to deny or grant benefits.[136] In *Firestone*, the employer—as plan administrator—determined that there was no reduction in the workforce under the terms of the plan, and thus, it denied severance benefits to a group of workers.[137] The Supreme Court invoked trust law and extended a highly deferential review (i.e., the abuse of discretion or the arbitrary and capricious standard of review) of a fiduciary's interpretation of the plan *provided* the terms of the plan had granted discretionary powers to the fiduciary to so interpret; if the terms of the plan were silent, a de novo standard of review was to be used.[138] As the plan administrator was the employer of a self-funded severance benefit plan, there was an apparent conflict of interest as the plan's administrator's interpretation of the plan could impact whether and how much would be paid as benefits under the terms of the plan. The Supreme Court simply noted that a conflict of interest must be weighted as a "factor in determining whether there is an abuse of discretion."[139]

Moench and amici argued that the application of the *Firestone* standard of judicial review should be limited to cases involving a fiduciary's denial of benefits to a participant (i.e., for claims under ERISA § 502(a)(1)(B)), as opposed to a fiduciary's breach of duty (i.e., for claims under ERISA § 502(a)(2))[140] Hence, they argued that the arbitrary and capricious standard should not apply.[141] They pointed to an

134. *Id.*
135. *Id.* at 563.
136. Firestone Rubber & Rubber Co. v. Bruch, 489 U.S. 101, 109 (1989).
137. *Id.* at 105–06.
138. *Id.* at 115.
139. *Id.*
140. *Id.* In its amicus brief to the Third Circuit, the DOL argued that ERISA's fiduciary duties do not mandate that an ESOP fiduciary purchase employer stock "regardless of the stock's price or the employer's financial condition," and thus should not extend to ESOP fiduciaries a presumption of prudence. Brief of the Secretary of Labor as Amicus Curiae Supporting Petitioner, Moench v. Robertson, 62 F.3d 533 (3d Cir. 1995) (No. 94-5637), 1994 WL 16012393 at *12.
141. Moench v. Robertson, 62 F.3d 553, 565 (3d Cir. 1995).

earlier Third Circuit opinion, *Struble v. New Jersey Brewery Employees' Welfare Trust Fund*,[142] which held that the arbitrary and capricious standard did not apply in the context of a breach of a fiduciary duty. In *Struble*, the plaintiffs alleged that the plan's trustees breached their fiduciary duty by failing to collect employer contributions to the plan and by applying surpluses to benefit the employer instead of the plan's retirees.[143] In deciding the appropriate standard of review, the court noted, that in a denial of benefits context, that the question is whether the trustees "correctly balanced the interests of present claimants against the interests of future claimants[,]" not whether the trustees "sacrificed the interests of the beneficiaries as a class in favor of some third party's interests[.]"[144] Thus, in the case where the trustees' actions are alleged to have failed to act in the interests of the beneficiaries, the more appropriate standard was the de novo standard of review.[145]

The Third Circuit in *Moench* contrasted the facts of *Struble*, noting that the former involved a fiduciary's decision to give a benefit to an employer rather than a beneficiary (i.e., the fiduciary had to decide which of two classes to favor), whereas *Moench* involved the Committee's interpretation of the plan and its investment decisions which did not favor non-beneficiaries at the expense of beneficiaries.[146] But the court noted that Moench's conflict of interest arguments bore on the second issue raised, i.e., whether the Committee's members' positions as directors made impartial decision-making impossible when deciding whether to invest plan assets in employer stock.[147] The court also noted that in contrast in *Struble,* the Committee's investment decision was consistent with the purpose of an ESOP plan.[148]

In fashioning a judicial standard of review, the Third Circuit returned to the *Firestone* decision and used trust law to determine the appropriate standard of review to apply when the claim is based on violations of ERISA's fiduciary duties.[149] But in analyzing the Committee's interpretation of the plan, the court applied the *Firestone* standard, and since the plan gave the Committee discretion as to interpreting the plan,

142. Struble v. N.J. Brewery Emp.'s Welfare Tr. Fund, 732 F.2d 325 (3d Cir. 1984).
143. *Id.* at 331.
144. *Id.* at 333–34.
145. *Id.* at 334.
146. *Moench*, 62 F.3d at 563.
147. *Id.*
148. *Id.*
149. *Id.* at 564–65.

it would apply the arbitrary and capricious standard.[150] Hence, it would "disturb its interpretation" only if its reading of the plan was unreasonable.[151] But the court rejected the Committee's interpretation that the plan document required plan assets to be invested *solely* in Statewide stock, when its terms stated that the assets were to be invested "primarily" in Statewide stock.[152] The court quoted *Central States, Southeast & Southwest Areas Health & Welfare Fund v. State Farm Mutual Automobile Insurance Co.*,[153] which applied the deferential standard of review when the trust gave the power of the fiduciary to interpret the document and the trustee in fact interpreted it.[154] As there was no record of the Committee's interpretation of the plan, the court concluded that *Moench* should be afforded the *Firestone* de novo standard of review.[155]

In applying de novo review of the plan document, the court concluded that it did not require the Committee to invest solely in Statewide stock.[156] As such, the district court erred in holding that the Committee had no choice but to invest in company stock.[157] The court then turned to the standard of review to be utilized in reviewing the fiduciary's investment decision to hold company stock.[158] The court looked to the language of ERISA, which does not hold an ESOP fiduciary to the standard of diversification of assets nor to the standard of prudence of failing to diversity.[159] It contrasted that with the legislative intent to promote employee ownership and to encourage employers to establish ESOPs.[160] The court concluded that its job is to balance these tensions under an abuse of discretion analysis.[161] Thus, it fashioned a new test: due to the purpose behind ERISA and the very nature of ESOPs, an ESOP fiduciary who invests the plan assets in employer stock is entitled to a "presumption" that it acted in accordance with ERISA and its duty of prudence.[162] According to the *Moench* court:

150. *Id.* at 566.
151. *Id.*
152. *Id.* at 567.
153. Trustees of Cent. States, Se. & Sw. Areas Health & Welfare Fund v. State Farm Mut. Auto. Ins. Co., 17 F.3d 1081, 1083 (7th Cir. 1994).
154. Moench v. Robertson, 62 F.3d 553, 567 (3d Cir. 1995).
155. *Id.*
156. *Id.* at 568.
157. *Id.* at 553.
158. *Id.* at 554.
159. *Id.* at 564.
160. *Id.* at 568–69.
161. *Id.* at 571.
162. *Id.*

> In attempting to rebut the presumption, the plaintiff may introduce evidence that "owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust."[163] As in all trust cases, the court, in reviewing the fiduciary's actions, must be governed by the intent behind the trust—in other words, the plaintiff must show that the ERISA fiduciary could not have reasonably believed that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate.[164]

Thus, there are a variety of ways to rebut this presumption: the first is to show facts unknown to the settlor of the trust and not anticipated by him that would defeat or harm the purpose of the trust (e.g., facts where an ERISA fiduciary could not have reasonably believed that adherence to the direction to continue to invest in company stock was in keeping with the settlor's belief as to how a prudent trustee would act).[165] The court noted in this case, where the ESOP fiduciaries as directors of the corporation "serve[d] two masters," ERISA's prudence standard of care require the fiduciary to make "a careful and impartial investigation of all investment decisions."[166] Hence, in this case, Moench's argument regarding the "precipitous decline" in the value of the employer stock, as well as the Committee's inside knowledge of the company's "impending collapse," were evidence that the Committee should have disregarded the terms of the plan or hired an impartial outsider to make investment decisions.[167] As the record was incomplete, the court remanded the case to the district court to develop such a record and to apply the principles discussed by the Third Circuit in its holdings.[168] Thus, the *Moench* presumption affirmed the fiduciaries' investment in employer stock as prudent unless the plaintiffs could show extraordinary changed circumstances that would demonstrate such investments were no longer consistent with the settlor's intent.

Two months later, the Sixth Circuit adopted the *Moench* presumption in *Kuper v. Iovenko*.[169] In *Kuper*, plaintiffs were former salaried employees of the Emery Division of Quantum Chemical Corporation ("Quantum"), who participated in an ESOP maintained by the

163. *Id.* at 557.
164. *Id.* (quoting RESTATEMENT (SECOND) OF TRUSTS § 227 cmt. g (AM. L. INST. 1959)).
165. Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).
166. *Id.* at 572 (quoting Martin v. Feilen, 965 F.2d 660, 670–71 (8th Cir. 1992)).
167. *Moench*, 62 F.3d at 572.
168. *Id.*
169. Kuper v. Iovenko (Quantum Chem. Corp.), 66 F.3d 1447 (6th Cir. 1995).

employer.[170] In March 1989, Quantum entered into an asset sale agreement to sell its Emery Division to Henkel Corporation ("Henkel"), effective April 17, 1989.[171] Under the terms of the agreement, Henkel agreed to continue to employ existing Emery employees and accept from Quantum a trust-to-trust transfer of plan assets for those employees.[172] The trust-to-trust transfer was not complete until eighteen months later, while the value of the Quantum stock declined in value from more than $50 per share to slightly more than $10 per share.[173] One of the issues presented to the court was whether the district court erred in finding that the defendants did not breach their fiduciary duty by failing to diversify or liquidate the ESOP funds after the sale of the Emery Division.[174]

Citing *Moench*, the Sixth Circuit held that a plan's per se prohibition against diversification or liquidation of employer stock would theoretically violate the purposes of ERISA as it would conflict with the fiduciary's duty to act in the best interest of the plan participants and beneficiaries.[175] As the ESOP in question did not contain a per se prohibition against diversification or liquidation, the court proceeded to apply the *Moench* presumption and inquired whether the plaintiffs could show that the fiduciary abused its discretion in continuing to hold employer stock.[176] While the plaintiffs alleged that the defendants admitted that they had not considered diversifying or liquidating the ESOP despite their knowledge of Quantum's financial problems, that fact alone did not demonstrate to the court that the fiduciary's decision was unreasonable.[177] Also the plaintiff's demonstration that the Quantum stock continued to decline in value over the eighteen-month time period was not sufficient to rebut the *Moench* presumption as its price fluctuated significantly during this period and several investment advisors recommending holding the stock.[178]

170. *Id.* at 1449.
171. *Id.* at 1451.
172. *Id.* at 1457.
173. *Id.*
174. *Id.* at 1458–59.
175. *Id.* at 1457.
176. *Id.* at 1459–60.
177. *Id.* (explaining that such fact did not demonstrate a causal link between the failure to investigate and the harm suffered by the plan).
178. *Id.* at 1460.

In the decade following the Third Circuit's decision, the Second,[179] Fifth,[180] Seventh,[181] Ninth,[182] and Eleventh Circuits[183] followed suit and adopted the *Moench* presumption. The presumption evolved as a standard for adjudicating the plan fiduciary's liability, requiring a showing of dire financial circumstances in order to be overcome.[184] Courts, however, have struggled with determining the stage at which the presumption should be applied.[185] The Third Circuit in *Moench* had prescribed the presumption when considering an evidentiary record from the district court on a motion for summary judgment from the defendants.[186] The Sixth Circuit in *Kuper* also adopted the *Moench* presumption in its review of the district court's judgment, which was based on the parties' trial briefs, proposed findings of facts and conclusions of law, and the stipulated record of the case.[187] Other district courts held differently, applying the presumption at the motion to dismiss stage, thus, requiring the plaintiff to plead sufficient facts to overcome the presumption in order to survive a motion to dismiss.[188]

179. *See In re* Citigroup ERISA Litig., 662 F.3d 128 (2d Cir. 2011); Taveras v. UBS AG, 708 F.3d 436 (2d Cir. 2013) (refusing to apply the presumption when the plan document did not require or strongly suggest investment in employer stock).

180. *See* Kirschbaum v. Reliant Energy Inc., 526 F.3d 243 (5th Cir. 2008).

181. *See* Howell v. Motorola, Inc., 633 F.3d 552, 568 (7th Cir. 2011); White v. Marshall & Ilsley Corp., 714 F.3d 980, 989 (7th Cir. 2013) (requiring plaintiffs to "allege and ultimately prove that the company faced 'impending collapse' or 'dire circumstances' that could not have been foreseen by the founder of the plan.") (internal citations omitted).

182. *See* Quan v. Comput. Scis. Corp., 623 F.3d 870, 882 (9th Cir. 2010) (explaining that to overcome the presumption, "plaintiffs must … make allegations that clearly implicate the company's viability as an ongoing concern or show a precipitous decline in the employer's stock … combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement.") (internal quotations and citations omitted); Harris v. Amgen, Inc., 738 F.3d 1026 (9th Cir. 2013), *vacated and remanded,* 573 U.S. 942 (2014).

183. *See* Lanfear v. Home Depot, Inc., 679 F.3d 1267 (11th Cir. 2012).

184. *See White*, 714 F.3d at 989.

185. *See* Moench v. Robertson, 62 F.3d 553, 572 (3d Cir. 1995), *cert. denied*, 516 U.S. 1115 (1996); Kuper v. Iovenko (Quantum Chem. Corp.), 66 F.3d 1447 (6th Cir. 1995); *see, e.g.*, *In re* Regions Morgan Keegan ERISA Litig., 741 F. Supp. 2d 844, 849 (W.D. Tenn. 2010).

186. *Moench*, 62 F.3d at 572.

187. *See Kuper*, 66 F.3d at 1452.

188. *See, e.g.*, *In re* Regions Morgan Keegan ERISA Litig., 741 F. Supp. 2d at 849 (noting that "[a]t least fourteen district courts in this Circuit have addressed this issue …" and have "overwhelmingly declined to apply the presumption of prudence" when considering a motion to dismiss); Dudenhoeffer v. Fifth Third Bancorp, 757 F. Supp. 2d 753, 758–59 (S.D. Ohio 2010). (Normally, under FED. R. CIV. P. 12(b)(6), if the complaint alleges sufficient facts, taken as true, to state a plausible claim for relief, it will survive a motion to dismiss.)

V. Fifth Third Bancorp. v. Dudenhoeffer

Although there have been several large settlements in stock drop litigation,[189] the *Moench* presumption proved hugely successful for defendants.[190] Then, in 2014, the Supreme Court addressed the use of the *Moench* presumption in the unanimous decision of *Fifth Third Bancorp v. Dudenhoeffer*,[191] due to the split in the courts as to whether the presumption applied at the pleading stage or only at summary judgment and beyond.[192] In *Dudenhoeffer*, plaintiffs were participants in an employer defined contribution retirement plan in which employee contributions and matching contributions from the employer were automatically invested in an ESOP.[193] The participants sued the plan fiduciaries as the employer stock price fell by seventy-four percent between July 2007 and September 2009.[194] The complaint alleged that the employer stock was overvalued and excessively risky for two reasons: (1) publicly available information indicated that a large part of the employer's business was involved in subprime lending, which could leave "creditors high and dry" and subprime borrowers became unable to repay their mortgages, and (2) nonpublic information indicated that the plan fiduciaries, who were corporate insiders, had deceived the market with material misstatements regarding the company's financial prospects.[195] Thus, the plaintiffs alleged the plan fiduciaries breached their fiduciary duties of prudence and loyalty in managing the plan's investment in employer securities, despite its precipitous decline in value.[196]

189. *See* Emile Hallez, *Wawa settles ESOP lawsuit for $21.6 million*, INVESTMENTNEWS (July 10, 2020), https://www.investmentnews.com/wawa-settles-esop-lawsuit-21m-194995.

190. *See Kuper*, 66 F.3d at 1452; *see, e.g.*, *In re Regions Morgan Keegan ERISA Litig.*, 741 F. Supp. 2d at 849.

191. *Dudenhoeffer*, 573 U.S. at 409.

192. *Id.* at 414–15 (comparing *In re* Citigroup ERISA Litigation, 662 F.3d 128, 139–140 (2d Cir. 2011), which applied the presumption at the pleading stage, thus requiring the plaintiff to establish that the employer was "in a 'dire situation' that was objectively unforeseeable by the settlor," with Pfeil v. State Street Bank & Trust Co., 671 F.3d 585, 592–96 (6th Cir. 2012), *cert. denied*, 568 U.S. 1063 (Dec. 3, 2012), which applied the presumption only at summary judgment and beyond, thus requiring the plaintiff to establish that a prudent fiduciary acting in similar circumstances would have made a different investment decision.).

193. *Dudenhoeffer*, 573 U.S. at 412.

194. *Id.* at 413–14.

195. *Id.* at 413.

196. Dudenhoeffer v. Fifth Third Bancorp, 757 F. Supp. 2d 753, 754 (S.D. Ohio 2010).

Relying on the *Moench* presumption that the plan fiduciaries' decision to remain invested in employer securities was reasonable, the district court held that this rule was applicable at the pleading stage and then concluded the allegations were insufficient to overcome it.[197] As it was in the Sixth Circuit's jurisdiction, the district court, relying on the *Kuper* case, granted the defendant's motion to dismiss, as the plaintiffs failed to allege facts which overcame the presumption.[198]

The Sixth Circuit reversed, affirming the use of the *Moench* presumption, but rejecting its use at the pleading stage.[199] As the allegations in the complaint were sufficient to state a claim for breach of fiduciary duty,[200] the lawsuit should have proceeded, and thus, the court remanded the case to the district court.[201]

Before the Supreme Court, the plan fiduciaries alleged the following arguments which were rejected by the court:

- As ERISA's prudence standard is judged in terms of what a prudent person would do "in the conduct of an enterprise of a like character and with like aims," an ESOP fiduciary's decision to buy more share of employer stock may be prudent as it promotes employee ownership of employer stock, even though it may be imprudent when viewed solely as an attempt to secure financial retirement benefits while avoiding excessive risk.[202] The Supreme Court rejected this argument as ERISA's duty of prudence should not depend on a specific nonpecuniary goal set forth in an ERISA plan.[203] ERISA's exclusive purpose standard requires the plan fiduciary to provide *financial* retirement benefits (while defraying reasonable

197. *Id.* at 758 (quoting Kuper v. Iovenko, 66 F.3d 1447, 1459 (6th Cir. 1995)).

198. *Dudenhoeffer*, 757 F. Supp. 2d at 760–61 (citing to the Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1095–96 (9th Cir. 2004), where a 72% decline in the value of the employer stock was insufficient to overcome the presumption of reasonableness).

199. Dudenhoeffer v. Fifth Third Bancorp, 692 F.3d 410, 418 (6th Cir. 2012) (citing to the Pfeil v. State St. Bank & Trust Co., 671 F.3d 585, 592 (6th Cir. 2012), *cert. denied*, 568 U.S. 1063 (Dec. 3, 2012), holding that the *Kuper* presumption "is not an additional pleading requirement and thus does not apply at the motion to dismiss stage.").

200. *Dudenhoeffer*, 692 F.3d at 419–20.

201. *Id.* at 423–24.

202. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 419–20 (2014). (In its Brief for the DOL as Amicus Curiae in Support of Appellants, in *Dudenhoeffer v. Fifth Third Bancorp*, No. 11-3012, U.S. Supreme Court (2014), the DOL argued against the presumption of prudence as ERISA prohibits a fiduciary from knowingly paying an inflated price for employer stock as it is neither prudent nor in the interest of the plan participants and beneficiaries to do so. In addition, ERISA's prudent man standard is not caveated with reference to "dire financial circumstances" or "imminent collapse," which the Sixth Circuit appears to interpret the *Kuper* presumption).

203. *Id.* at 420.

expenses in administering the plan) and does not cover non-pecuniary benefits such as ownership in employer stock.[204] While ERISA requires the plan fiduciary to act in accordance with documents and instruments governing the terms of the plan, the duty of prudence "trumps the instructions of a plan document" as ERISA's prudence standard is altered for an ESOP plan fiduciary "only to the extent that it requires diversification."[205]

- The plan fiduciaries argued that ERISA's duty of prudence should be construed in light of the common law of trusts rule that "the settlor can reduce or waive the prudent man standard of care by specific language in the trust document."[206] As such, the plan document may waive the duty of prudence to the extent it conflicts with investment of employer stock unless "extraordinary circumstances" exist which would threaten the goal of owning employer stock.[207] The Supreme Court rejected this argument as that, in contrast to the rule at common law, "trust documents cannot excuse trustees from their duties under ERISA."[208]
- The plan fiduciaries next argued that subjecting ESOP fiduciaries to a duty of prudence without the protection of the *Moench* presumption would lead to conflicts with the securities laws' mandate against insider trading.[209] While acknowledging that this concern was a legitimate one, an ESOP-specific rule that a plan fiduciary does not act imprudently when buying or holding employer stock unless the employer is "on the brink of collapse (or the like)" was not a viable standard according to the Court.[210] It acknowledged that while ESOP fiduciaries may be more likely to be insiders as compared to other ERISA fiduciaries, the potential for conflict with

204. *Id.*

205. *Id.* at 420–21.

206. *Id.* at 422 (citing G. Bogert & G. Bogert, Law of Trusts and Trustees § 541, p.172 (rev. 2d ed. 1993) and RESTATEMENT (SECOND) OF TRUSTS § 174, cmt. d (AM. L. INST. 1957)).

207. *Id.*

208. *Id.* at 422–23 (citing Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., 472 U.S. 559, 568 (1985)).

209. *Id.* (The SEC did not submit an amicus brief in the *Dudenhoeffer* case. In its Brief for Securities Industry and Financial Markets Association in Support of Petitioners, *Fifth Third Bancorp v. Dudenhoeffer*, No. 12-751, U.S. Supreme Court (2014), the trade association known as Securities Industry and Financial Markets Association (SIFMA) pressed the Court for a strong presumption of prudence in allowing participants in a defined contribution plan to invest in employer stock. SIFMA indicated that ERISA stock-drop cases were often joined by securities fraud suits. The Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737, added heightened pleading standards, an automatic stay on discovery, and a structured lead plaintiff appointment process in an effort to discourage litigation. Allowing a plausible ERISA imprudence claim without the use of a presumption would undermine the hurdles imposed by PSLRA).

210. *Id.*

the securities laws exists for a non-ESOP fiduciary who has inside information about an investment.[211]

- Lastly, the plan fiduciaries argued that without the use of the *Moench* presumption the threat of costly lawsuits would deter employers from offering ESOPs to their employees, contrary to the intent of Congress.[212] As such, ESOP fiduciaries would be "between a rock and a hard place": they would be held liable *either* for the employer stock's poor performance if they continue to hold the stock or for a missed opportunity to benefit from its good performance if they decided not to hold the stock.[213] But the Court noted that ERISA requires a "careful balancing" between enforcing participant's rights under the plan and avoiding a system that is so complex that the administrative and litigation costs discourage employers from offering such plans.[214] It then rejected the use of a presumption to preserve such "balancing," as it makes it impossible for a plaintiff to state a duty of prudence claim and it does not "divide the plausible sheep from the meritless goats."[215] It also noted another feature for weeding out meritless claims: the motion to dismiss for failure to state a claim.[216] As ERISA's duty of prudence is based on "the circumstances. . . prevailing" at the time the fiduciary acts, it is *context specific*.[217] Thus, the Sixth Circuit was correct in that the plan participants had stated a plausible duty-of-prudence claim, which should have been allowed to go forward.[218]

The plaintiff plan participants in turn made the following arguments:

- The plan fiduciaries should have known in light of *publicly* available information (e.g., the decline in the stock's value as a result of the collapse of the housing market), that continuing to hold employer stock was imprudent.[219] The Supreme Court rejected the argument that the plan fiduciaries should have known from publicly available information *alone* that the market had over- or under-valued the stock.[220] In the words of the

211. *Id.*
212. *Id.*
213. *Id.* at 424.
214. *Id.* at 424–25 (citing to Conkright v. Frommert, 559 U.S. 506, 517 (2010), which quoted Aetna Health, Inc. v. Davila, 542 U.S. 200, 215 (2004)). *See also* Varity Corp. v. Howe, 516 U.S. 489, 497 (1996).
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.* at 425–26.
219. *Id*. at 426.
220. *Id.* at 426–27 (quoting from Summers v. State Street Bank & Trust Co., 453 F.3d 404, 408 (7th Cir. 2006) that a fiduciary usually "is not imprudent to assume that a major stock market … provides the best estimate of the value of the stocks traded on it that is available to him," and White v. Marshall & Illsley Corp., 714 F.3d

Court, "where the stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone that the market was over- or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances."[221] As the facts posed in this case did not point to "special circumstances" that would reflect the reliability of the market price (e.g., "an unbiased assessment of security's value in light of all public information"),[222] the fiduciary could prudently rely on the market price. Unfortunately for future lower courts, the Court did not define what was meant by "special circumstances."

- The plan participants next argued that the plan fiduciaries acted imprudently on the basis of *nonpublic* information, as they were Fifth Third insiders, which they should have relied upon to prevent losses to the plan's funds by selling off the employer stock, refraining from making future purchases of employer stock, or by publicly disclosing the inside information so that the market could correctly adjust the stock price.[223]

In response to the plaintiff's arguments, the Court held that "[t]o state a claim for breach of the duty of prudence" imposed on plan fiduciaries by ERISA "on the basis of inside information, a 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 in the same circumstances would not have viewed as more likely to harm the fund than to help it."[224]

In justifying this new standard, the Court noted the following three considerations that are to "inform the requisite analysis."[225] *First*, ERISA's prudence standard does not require a plan fiduciary to violate federal securities laws in deciding whether to divest the fund's holding in employer stock.[226] *Second*, in determining whether the plan fiduciaries should have refrained from buying additional stock or disclosed insider information to the market, the courts should consider the extent to which ERISA's standards conflict with complex insider trading and corporate disclosure requirements imposed by federal securities law or

980, 992 (7th Cir. 2013) that a fiduciary's "fail[ure] to outsmart a presumptively efficient market … is … not a sound basis for imposing liability").

221. *Id.* at 426–27.

222. *Id.* at 427 (quoting Halliburton Co. v. Erica P. John Fund Inc., 573 U.S. 258, 273 (2014), which quoted Amgen Inc. v. Conn. Ret. Plans & Trust Funds, 568 U.S. 455, 462 (2013)).

223. *Id.* at 427–28.

224. *Id.* at 428 (emphasis added); Ret. Plans Comm. of IBM v. Jander, 140 S. Ct. 592, 594 (2020).

225. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 428–30 (2014).

226. *Id.* at 428.

with their objectives.[227] To that end, the Court noted that the "U.S. Securities and Exchange Commission has not advised us of its views on these matters, and we believe those views may well be relevant."[228] *Third*, lower courts should also consider whether a prudent fiduciary in the defendant's position could not have concluded that by stopping purchase of employer stock, it would signal to the market that the stock was a bad investment due to their inside knowledge—or that publicly disclosing negative information "would do more harm than good" to the fund due to the drop in the stock price.[229]

The Court vacated the judgment of the Sixth Circuit and remanded the case for further proceedings consistent with its opinion.[230] The Court required plaintiffs to allege a plausible claim to overcome a motion to dismiss.[231] In this regard, it created two different standards for plaintiffs to proceed in alleging stock drop cases based on the plan's fiduciary action (e.g., holding on to the stock) or inaction (e.g., failing to remove the stock):

- If the claims were based on publicly available information that the plan fiduciary knew or should have known would render their decision imprudent to purchase or to refrain from purchasing employer stock, the plaintiff must allege "special circumstances" as to why the market price was unreliable. The Court subscribed to the efficient market hypothesis, which means the market adjusts the stock price accordingly based on all public information that it has about the stock.[232] As noted earlier, the Court did not define what constituted "special circumstances" for purposes of this standard.
- If the claims were based on nonpublic inside information that the plan fiduciary knew would render their decision imprudent to purchase or to refrain from purchasing employer stock, the plaintiffs must (1) allege that the fiduciary had an alternative course of action that it could have taken consistent with

227. *Id.* at 429.
228. *Id.*
229. *Id.* at 429–30.
230. *Id.* at 430. Note the Supreme Court's decision in *Dudenhoeffer* involved an ESOP of a publicly traded company. It is unclear as to whether it applies in stock drop litigation of an ESOP of a privately held company. *See* Hill v. Hill Brothers Construction Co., No. 14CV213, 2016 WL 1252983 (N.D. Miss. Mar. 28, 2016) (applying the *Dudenhoeffer* pleading standing in the context of an ESOP of a privately held company). *But see* Allen v. GreatBanc Trust Co., 835 F.3d 670, 679–80 (7th Cir. 2016) (rejecting the *Dudenhoeffer* pleading standard in the context of an ESOP of a privately held company). *See Dudenhoeffer Focuses on Public Companies: Attorneys Mull Application to Private ESOPs*, 41 BNA Pens. & Bens. Rptr. 1947 (2014) (discussing the implications of *Dudenhoeffer* on ESOPs of privately held companies).
231. *Fifth Third Bancorp. v. Dudenhoeffer*, 573 U.S. 409, 426–27 (2014).
232. *Id.* at 426.

> securities laws and (2) demonstrate that a prudent fiduciary in the same circumstances could not have concluded that such alternative action would do more harm than good to the plan's funds.[233]

Immediately following the *Dudenhoeffer* decision, it was not clear whether the decision would continue to be more favorable for defendants than for plaintiffs. Stock-drop litigation in the seven years following *Dudenhoeffer*, however, has proven that "*Dudenhoeffer* appears to have *raised* the bar for plaintiffs seeking to bring a claim based on a breach of the duty of prudence."[234] Aside from some notable large settlements in which employers conceded in order to avoid the cost of litigation,[235] plaintiffs have been unable to succeed on both public information and nonpublic-information-based claims.[236] Plan fiduciaries, however, cannot ignore the threat of stock drop litigation due to the possibility of large settlements.[237] The benefits community has also seen several instances of "reverse" stock drop litigation (e.g., the fiduciary sold the stock too soon, thereby denying the plaintiffs the benefit of the appreciation).[238] Thus, plan fiduciaries should be watchful of the risks of both types of litigation—stock drop and "reverse" stock drop.

233. *Id.* at 428.
234. *In re* Lehman Brothers, Secs. & ERISA Litig., 113 F. Supp. 3d 745, 755 (S.D.N.Y. 2015).
235. *Id.*
236. Quan v. Computer Sciences Corp., 623 F.3d 870, 880–81 (9th Cir. 2010) (adopting the *Moench* presumption).
237. *Id.*
238. *See* Tatum v. RJR Pension Inv. Comm., 855 F.3d 553 (4th Cir. 2017).

VI. The Aftermath of Dudenhoeffer Until 2018

The following post-*Dudenhoeffe*r and pre-*Jander* federal circuit cases are illustrative of the difficulties that plaintiffs have had in arguing stock drop litigation. This section begins with a case from the Ninth Circuit as the Supreme Court commented on the case for a second time post-*Dudenhoeffer.*

A. Ninth Circuit analysis

In *Amgen Inc. v. Harris*, the Supreme Court considered for a second time a complaint initially filed pre-*Dudenhoeffer* by the participants of a defined contribution plan, sponsored by Amgen Inc. and its subsidiary, that offer employer stock as an investment option.[239] This case from the Ninth Circuit has a torturous past. The participants sued the plan's fiduciaries on the grounds that they breached their fiduciary duties by allowing the plan to purchase and hold employer stock in light of the decline in the value of the employer stock.[240] The complaint alleged that the plan fiduciaries breached their ERISA fiduciary duty of prudence by remaining invested in company stock notwithstanding their inside knowledge over safety concerns related to one of its most popular drugs.[241] When those safety concerns became public, the company stock price dropped in value, negatively impacting the participants' account values.[242] The district court dismissed their claims after applying the Ninth Circuit's *Quan* presumption of prudence, and alternatively, assuming the presumption did not apply, on the ground that the defendants had not violated their fiduciary duties.[243] The Ninth Circuit reversed the dismissal, holding that the *Quan* presumption of prudence no longer applied as a result of *Dudenhoeffer* and, in the absence of the presumption, the plaintiffs had sufficiently alleged a violation of ERISA's fiduciary duties (referred to as *Harris I*).[244] Its reasoning was twofold:

- While removing the employer stock as a plan investment option would have sent a negative signal to the public, which may have caused a drop in the stock price, several factors

239. *See generally* Amgen Inc. v. Harris, 136 S. Ct. 758 (2016).
240. Harris v. Amgen, Inc., No. CV 07-5442, 2010 U.S. Dist. LEXIS 26283 at *4 (C.D. Cal. Mar. 2, 2010).
241. *Id.*
242. *Id.*
243. *See id.*
244. Harris v. Amgen, Inc. (Harris I), 738 F.3d 1026, 1047 (9th Cir. 2013).

mitigated such a result, making it highly unlikely that the fiduciary's action could have negatively impacted the stock price;[245] and

- "If defendants had revealed material information in a timely fashion to the general public . . . .. . thereby allowing informed plan participants to decide whether to invest . . . . they would have simultaneously satisfied their duties under both the securities laws and ERISA."[246]

The defendants in *Harris I* petitioned for writ of certiorari, which the Supreme Court granted; the Supreme Court then vacated and remanded the Ninth Circuit's decision for reconsideration in light of the issues of the *Dudenhoeffer* decision.[247]

On remand, the Ninth Circuit again reversed the district court's dismissal—arguing that the complaint properly stated a claim for breach of fiduciary duty—and denied the fiduciaries' petition for rehearing en banc ("*Harris II*").[248] It acknowledged that the plaintiffs had shown it was "plausible" that the Amgen stock was "artificially inflated" as a result of material misrepresentations and omissions by company officers.[249] The court concluded that if the alleged misrepresentations and omissions were sufficient to state a claim that the defendants violated federal securities law, they are certainly sufficient to state a claim that the defendants violated ERISA's duty of care.[250] The *Harris II* decision was the first instance of a court of appeals applying *Dudenhoeffer*.

The Supreme Court reversed and remanded the Ninth Circuit's second decision, in a single order and per curiam opinion, signaling that the Ninth Circuit's interpretation of *Dudenhoeffer* neglected to apply its new rigorous pleading standards.[251] The Court stated that the Ninth Circuit had failed to assess whether the complaint in its current form "has plausibly alleged" that a prudent fiduciary in the same position "could not have concluded" that the alternative action "would do more harm than good."[252] The Court then examined the complaint and

245. *Id.* at 1041.
246. *Id.* at 1041–42.
247. Amgen Inc. v. Harris, 134 S. Ct. 2870, 2871 (2014).
248. Harris v. Amgen, Inc. (*Harris II*), 788 F.3d 916, 945–46 (9th Cir. 2014), *denying petition for rehearing en banc and amending and replacing prior opinion* at 770 F.3d 865 (9th Cir. 2014).
249. *Harris II*, 788 F.3d at 921.
250. *Id.* at 942.
251. Amgen Inc. v. Harris, 136 S. Ct. 758, 760 (2016).
252. *Id.* at 759–60 (quoting from Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 429–30 (2014)).

found there were not sufficient facts and allegations to state a claim for breach of the duty of prudence.[253] This decision signaled to the courts to rigorously review the terms of the complaint and reject conclusory assertions of an ERISA fiduciary breach, so as to "divide the plausible sheep from the meritless goats."[254]

In *Laffen v. Hewlett-Packard Co.*, an unpublished opinion, the Ninth Circuit affirmed the district court's dismissal of plaintiffs' complaint on the grounds that it did not meet the *Dudenhoeffer* standard for a breach of duty of prudence on the basis of inside information.[255] Current and former employees of Hewlett-Packard Company (HP) initiated a class action against the plan fiduciaries by purchasing and holding HP common stock in HP's 401(k) Savings Plan, even though the stock was artificially inflated.[256] HP had attempted to acquire Autonomy Corporation PLC ("Autonomy"), a British software company.[257] The plaintiffs alleged that HP hid knowledge of Autonomy's inflated stock value until a whistleblower forced it to investigate and disclose the results.[258] For purposes of stating a claim for a breach of fiduciary duty on the basis of inside information, the plaintiffs alleged that HP should have first investigated the whistleblower's allegations before taking action, as a prudent fiduciary would have first investigated the problem before acting.[259] The court rejected that this was an alternative action that the defendants could have taken, consistent with securities law, and one that a "similarly situated prudent fiduciary would not have viewed as more likely to harm than help the plan."[260] Thus, it held that the plaintiffs failed to plead a claim for breach of the fiduciary duty of prudence in this context.[261]

B. Second Circuit analysis

In *In re Citigroup ERISA Litig.*, participants in a Citigroup defined contribution plan alleged various defendant executives were responsible for the plans' investments and subsequently violated their fiduciary

253. *Amgen Inc.*, 134 S. Ct. at 759–60.
254. *Id.* at 310.
255. Laffen v. Hewlett-Packard Co., 721 F. App'x 642, 644 (9th Cir. 2018).
256. *Id.* at 643.
257. *Id.*
258. *Id.* at 644.
259. *Id.*
260. *Id.* at 643.
261. *Id.* at 644.

duty of prudence to continue to hold and buy company stock in light of its decline in value.[262] The district court rejected their claims that the defendants knew or should have known that Citigroup stock was an imprudent investment based on public information as they did not point to any "special circumstances," as required by *Dudenhoeffer*, that would render reliance on the market price to be impudent.[263] Thus, their duty-of-prudence claim based on publicly available information was dismissed.[264] As to the plaintiffs' claim that the defendants failed to act prudently in response to nonpublic information, the court dismissed that claim as well.[265] The plaintiffs argued disclosure of any nonpublic information could not have caused the stock price to move noticeability in light of all the negative public information about Citigroup.[266] Thus, they argued the purported nonpublic information that could have been disclosed was immaterial.[267] The court rejected that argument, because the plaintiffs did not show that there was nonpublic information that "would have altered the 'total mix' of available knowledge," they did not show that the information was material.[268] The Second Circuit affirmed the district court, noting the claim regarding nonpublic information failed because the appellants did not allege an alternative action that a prudent fiduciary could have taken that it would not have viewed as more likely to harm the fund than to help it, quoting from *Dudenhoeffer*.[269]

In *Rinehart v. Lehman Bros. Holdings Inc.*, the Second Circuit affirmed the district court's dismissal of the plaintiff's third consolidated amended complaint, alleging breach of duties by the fiduciaries of an ESOP, invested exclusively in Lehman Brothers Holdings, Inc. ("Lehman") stock.[270] The plaintiff's alleged that the SEC's orders prohibited the short-selling of securities of certain financial services firms, which included Lehman, constituted "special circumstances" under the

262. *In re* Citigroup ERISA Litig., 104 F. Supp. 3d 599, 602–03 (S.D.N.Y. 2015), *aff'd sub nom.* Muehlgay v. Citigroup, Inc., 649 F. App'x 110 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 583 (2016).
263. *Id.* at 615.
264. *Id.* at 616.
265. *Id.*
266. *Id.*
267. *Id.* at 616–17.
268. *Id.* at 617.
269. Muehlgay v. Citigroup, Inc., 649 F. App'x 110, 112 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 583 (2016).
270. Rinehart v. Lehman Brothers Holding, Inc., 817 F.3d 56, 63 (2d Cir. 2016), *cert. denied*, 137 S. Ct. 1067 (2017).

Dudenhoeffer criteria such that the fiduciaries should not have relied upon the market value of the employer stock.[271] Because those SEC orders spoke only conditionally about market effects resulting from so-called naked short sales, they did not purport to describe the existing market conditions.[272] The court noted that the plaintiff's "conclusory assertions" did not give rise to a plausible inference that the SEC's orders would have affected the market's ability to value Lehman stock, and thus, it need not decide whether such orders constituted "special circumstances" under *Dudenhoeffer*.[273] Thus, in the court's eyes, the fiduciary could rely on the market price as a shield against "*all* allegations of imprudence based upon public information."[274]

The plaintiffs also alleged that the fiduciaries breached their duties by failing to investigate nonpublic information regarding the risks of Lehman.[275] The Second Circuit rejected this allegation as the complaint failed to explain how such investigation would have uncovered any inside information, as *Dudenhoeffer* requires the plaintiff to allege facts which would show that such an adequate investigation would have revealed to a prudent fiduciary that the investment was "improvident."[276] Moreover, the Second Circuit held that the plaintiffs did not plausibly plead facts and allegations showing that a prudent fiduciary would not have viewed disclosure of material nonpublic information regarding Lehman or ceasing to buy Lehman stock as more likely to harm the fund than to help it.[277] Thus, the plaintiffs failed to plead plausibly that the defendants breached their fiduciary duties under ERISA by failing to recognize the imminence of Lehman's collapse.[278]

C. Fourth Circuit analysis

In the case of *Tatum v. RJR Pension Investment Committee*, RJR Nabisco ("Nabisco") as plan fiduciary informed plan participants that the Nabisco stock fund would be frozen, as it decided to spin off the company's food business from its tobacco business, and then would be

271. *Id.* at 66–67.
272. *Id.* at 67.
273. *Id.*
274. *Id.* at 66.
275. *Id.* at 61, 67.
276. *Id.* at 67.
277. *Id.* at 68 (quoting from Amgen Inc. v. Harris, 136 S. Ct. 758, 759 (2016).
278. Rinehart v. Lehman Brothers Holding, Inc., 817 F.3d 56, 68 (2d Cir. 2016).

divested six months later.[279] In the months following the spin-off, Nabisco stock declined sharply in value; however, months after the divestment, the value of the Nabisco stock increased dramatically in value after being acquired by Philip Morris.[280] Employees of Nabisco sued the plan fiduciaries for breaching their fiduciary duty "by eliminating Nabisco stock from the Plan on an arbitrary timeline without conducting a thorough investigation,"[281] which then caused substantial loss to the plan.[282] The Fourth Circuit affirmed the district court's conclusion that absent "special circumstances" when evaluating publicly traded stock, the plan fiduciary may rely on the market price of the Nabisco stock as the correct estimate of its value (consistent with the efficient market theory hypothesis).[283] It concluded that Nabisco's actions were consistent with what a prudent fiduciary "would have" decided when to divest and how to divest.[284]

D. Fifth Circuit analysis

In September of 2016, the Fifth Circuit concluded a six-year battle against the executives of BP, P.L.C. ("BP") as plan fiduciaries, for losses in BP stock prices held in BP's employee stock ownership plan, due to the 2010 explosion of an offshore drilling rig causing a massive oil spill in the Gulf of Mexico.[285] As the original complaint had been filed pre-*Dudenhoeffer*, the district court initially dismissed the complaint on the grounds that the ESOP fiduciaries were entitled to a presumption of prudence under the *Kirschbaum* standard, which the plaintiffs failed to overcome.[286] The Fifth Circuit vacated the district court's judgment and remanded for reconsideration in light of the Supreme Court's *Dudenhoeffer* decision.[287]

279. Tatum v. RJR Pension Inv. Comm., et al., 855 F.3d 553, 556 (4th Cir. 2017).
280. *Id.* at 556–57.
281. *Id.* at 557 (quoting from Tatum v. RJR Pension Inv. Comm., 761 F.3d 346, 355 (4th Cir. 2014)).
282. *Id.*
283. *Tatum*, 855 F.3d at 564.
284. *Id.* at 567.
285. Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016).
286. *Id.* at 525–26; Kirschbaum v. Reliant Energy, Inc., 526 F.3d 243, 255 (5th Cir. 2008) (applying the *Moench* presumption of prudence).
287. Whitley v. BP, P.L.C., 575 F. App'x 341, 343 (5th Cir. 2014) (vacating the judgement of the district court and remanding it for reconsideration in light of *Dudenhoeffer*, as the district court had applied the *Moench* presumption).

On remand, the complaint was amended and the district court held that (1) the stockholders had plausibly alleged that the defendants had inside information and (2) the stockholders had plausibly alleged two alternative actions that the defendants could have taken that met the *Dudenhoeffer* criteria: freezing, limiting, or restricting the purchase of employer stock and disclosing unfavorable information to the public.[288] The Fifth Circuit reversed and remanded, stating that the district court altered the language of *Dudenhoeffer* in reaching its holdings.[289] According to the Fifth Circuit, the district court stated that it could not determine "on the basis of the pleadings alone, that *no* prudent fiduciary would have concluded that [the alternatives] would do *more good than harm*."[290]

The Fifth Circuit corrected the district court's interpretation by saying that the *Dudenhoeffer* language imposed a "significant burden" on the plaintiff to propose an alternative course of action "so *clearly* beneficial that a prudent fiduciary *could not conclude* that it would be more likely to harm the fund than to help it."[291] Thus, the plaintiff has the burden of showing that the alternative action must do *more* than resulting in a net gain to the fund; he or she must "plausibly allege that no prudent fiduciary could have" made the opposite conclusion (i.e., that such alternative would result in more harm than good).[292] The Fifth Circuit charged the stockholders with making "conclusory statements" that did not demonstrate proposed alternatives that a prudent fiduciary could not have concluded would do more harm than good.[293] While the stockholders alleged that the BP stock was overvalued due to "numerous undisclosed safety breaches" known only to insiders, that fact alone was not sufficient to conclude that disclosure of such information or freezing trades of BP stock (both of which would reduce the stock price) would do more harm than good.[294] In fact, the Fifth Court inferred a prudent fiduciary would have concluded that such actions would do more harm than good.[295] As the stockholders failed to do so, their claim should have been dismissed.[296] The Fifth Circuit also failed to comment

288. *Id.* at 526.
289. *Id.* at 528–29.
290. *Id.* at 529.
291. *Id.* (with emphasis added).
292. *Id.*
293. *Id.*
294. *Id.* at 523.
295. *Id.* at 529.
296. *Id.* at 523.

on amicus briefs filed by the DOL and SEC which argued in favor of public and prompt disclosure of all material nonpublic information.[297]

A year later, the plaintiffs filed an amended complaint.[298] The Fifth Circuit again framed the issue as to whether "plaintiffs [have] plausibly allege[d] that no prudent fiduciary could have concluded" that public disclosure of negative information would do more harm than good.[299] In their amended complaint, the plaintiffs first alleged that public disclosure of negative information should have been set forth in the ordinary Securities and Exchange Commission's public filings.[300] Secondly, to qualify the effect of such disclosure, the plaintiffs brought in testimonies of financial markets experts.[301] Such arguments fell on deaf ears, as the Fifth Circuit held that such allegations failed to show how public disclosure would have led to improved results.[302]

Two years later, in *Martone v. Robb*,[303] the Fifth Circuit affirmed the district court's dismissal of the plaintiff's claims against executives of Whole Foods, as plan fiduciaries, for continuing to hold Whole Foods stock in the company's ESOP.[304] Martone alleged that the company stock was artificially inflated as a result of "undisclosed misrepresentation and fraud," as Whole Foods had been involved in "systemic, illegal

297. *See generally* Brief for the Department of Labor as Amicus Curiae, in Support of the Plaintiff-Appellees, Whitley v. BP, P.L.C., No. 15-20282 (5th Cir. 2016); Brief for the SEC as Amicus Curiae in Support of the Plaintiffs-Appellees, Whitley v. BP, P.L.C., No. 15-2028 (5th Cir. 2016) (The DOL had argued that plaintiff-appellees had satisfied the "more harm than good" standard by alleging at least two actions that the defendants could have taken: freeze the stock fund and, if necessary, make a public disclosure, consistent with the securities laws, that a prudent fiduciary could not have concluded would do more harm than good given the continuous fraud. In the wake of an ongoing fraud, the fiduciary's objectives, under both ERISA and the securities law, must be to halt the fraud and prevent the plan from continuing to hold and buy overvalued stock. In its amicus brief, the SEC argued that the alternative actions set forth by the DOL are not inconsistent with the federal securities laws or their objectives. If the ESOP manager engages in a fraud by making misstatements or omissions, he/she owed a duty to make a public disclosure of the falsehood. If the ESOP manager was not responsible for the fraud but knows of it, he/she may elect to disclose it publicly. In the SEC's view, an ESOP manager aware of the employer's undisclosed fraud will not violate securities law by refraining from both purchases and sales of employer stock within the plan.).

298. *In re* BP P.L.C. Sec. Litig., No. 10-cv-4214, 2017 U.S. Dist. LEXIS 33302, at *78 (S.D. Tex. Mar. 8, 2017).

299. *Id.* (citing Whitley v. BP, P.L.C., 838 F.3d 523, 523 (5th Cir. 2016)).

300. *Id.* at *76–77.

301. *Id.*

302. *Id.* at *83–84.

303. Martone v. Robb, 902 F.3d 519, 528 (5th Cir. 2018).

304. *Id.* at 521.

overcharging of its customers" by "regularly misstat[ing] the weight of pre-packaged food on which prices were based."[305] The company had been investigated, during this time period, by a number of governmental agencies in California and New York, resulting in fines and a permanent injunction to prohibit to engaged in practices that involved products sold by weight.[306] It too had disclosed in its Form 8-K filing that the company's stock price declined over eleven percent.[307]

As a result of the alleged fraud, Martone, a former Whole Foods employee, claimed that the defendants should have made corrective, public disclosures to cure such fraud.[308] He argued that disclosing the fraudulent conduct *earlier* would have reduced the damage as "the longer a fraud of a public company like Whole Foods persists, the harsher the correction is likely to be when that fraud is finally revealed."[309] The district court rejected that argument as it concluded that "in virtually every fraud case," a prudent fiduciary could have concluded that taking such action to expose fraudulent conduct might do more harm than good.[310] The Fifth Circuit agreed that fraud disclosures and the decline in stock price that subsequently followed were insufficient under the *Whitley* standard.[311]

The court also dismissed the plaintiff's claim that the plan would be a net purchaser of the stock during the class period and thus, any benefit to the sellers should have been factored into court's analysis as to whether earlier disclosure would cause more harm than good.[312] The court noted such an argument flies in the face of ERISA's duty of prudence which is determined "under the circumstances then prevailing,"[313] and not with the benefit from hindsight.[314] Thus, the Fifth Circuit affirmed the dismissal as Martone failed to allege alternative actions that a prudent fiduciary "would not have viewed as more likely to harm the fund than to help it."[315]

305. *Id.* at 521–22 (internal quotations omitted).
306. *Id.* at 522.
307. *Id.*
308. *Id.* at 521, 525.
309. *Id.* at 526.
310. *Id.*
311. *Id.* at 527.
312. *Id.*
313. 29 U.S.C. § 1104(a)(1)(B).
314. Martone v. Robb, 902 F.3d 519, 527 (5th Cir. 2018).
315. *Id.* at 529.

E. Eleventh Circuit analysis

In *Smith v. Delta Air Lines*, the Eleventh Circuit affirmed the district court's decision to dismiss a lawsuit by plan participants of a Delta Air Lines ("Delta") ESOP for breach of their fiduciary duty of prudence under *Dudenhoeffer*.[316] The lawsuit had alleged that the fiduciaries imprudently invested in the employer stock in light of the disappointing financial performance, loss in competitive advantage, and concerns about the employer's ability to survive in its industry.[317] By the fiduciaries' failure to investigate the viability of the Delta stock and its adherence to the plan document, regardless of the harm to the participants, the plaintiffs alleged that the fiduciaries breached their duty of prudence.[318] On remand and relying on the *Dudenhoeffer* criteria, the Eleventh Circuit found these claims implausible on the grounds that "special circumstances" (such as fraud, improper accounting, or illegal conduct) were not alleged to show that the fiduciaries' reliance on the market price of the stock was imprudent.[319] The court also noted that there was no allegation in the complaint that the fiduciary had material inside information about Delta's financial condition that had not been disclosed to the market.[320]

F. Seventh Circuit analysis

In *Allen v. GreatBanc Trust Co.*, the Seventh Circuit reversed the district court's dismissal of the plaintiffs' complaint as they had not sufficiently pleaded a breach of fiduciary duty according to the *Dudenhoeffer* standard by showing "special circumstances" that the plan stock had been undervalued.[321] The employer was a privately held company and appointed GreatBanc in 2010, as trustee of the ESOP, for the purpose of representing the plan in purchasing shares in the company for $60 million, secured with a loan from the selling shareholders.[322] Twenty-two days later, the plan's stock was alleged to have declined by twenty-two

316. Smith v. Delta Air Lines, Inc., 619 F. App'x 874 (11th Cir. 2015). The Supreme Court had vacated the Eleventh Circuit's prior ruling in favor of the fiduciaries and remanded the case for reconsideration in light of *Dudenhoeffer*. Smith v. Delta Air Lines Inc., 563 F. App'x 681 (11th Cir. 2014), *vacated and remanded*, 135 S. Ct. 1421 (2015).

317. *Smith*, 619 F. App'x. at 875.

318. *Id.*

319. *Id.* at 876.

320. *Id.*

321. Allen v. GreatBanc Trust Co., 835 F.3d 670, 681 (7th Cir. 2016).

322. *Id.* at 673.

percent; by late 2011, its value had declined by almost fifty percent.[323] By December 2013, its shares were worth only $26.6 million.[324] Employees Lisa Allen and Misty Dalton brought suit, alleging a breach of fiduciary duty claim due to the decline in the value of the stock.[325] The district court dismissed the complaint believing that the *Dudenhoeffer* standard of "special circumstances" applied, as it found that no special circumstances existed.[326] The Seventh Circuit reversed as it held the *Dudenhoeffer* standard regarding the value of the stock did not apply in the context of a private-stock situation.[327] As a result, the plaintiff need only plead a breach of fiduciary duty, such as prudence, and explain how the breach occurred.[328]

G. Sixth Circuit analysis

In *Saumer v. Cliffs Natural Resources, Inc.*, the Sixth Circuit affirmed the district court's dismissal of the plaintiffs' stock drop complaint.[329] Cliffs Natural Resources ("Cliffs") employees who were participants in an ESOP alleged that the plan fiduciaries, consisting of the plan's investment committee members and Cliffs corporate officers, breached their fiduciary duty by retaining Cliffs stock as an investment option.[330] Due to a 2012 global demand slump, the Cliffs stock lost ninety-five percent of its value between 2011 and 2015, as compared to a roughly fifty percent gain for the broader market during the same time period.[331] The plaintiffs alleged that the fiduciary's decision to invest in the Cliffs stock was imprudent because the company's risk profile and business prospects had declined precipitously during the class period.[332] The court rejected this argument as it applied the *Dudenhoeffer* standard in both contexts—whether the company stock was overvalued or excessively risky—thereby allowing the plan fiduciaries to rely on the

323. *Id.*
324. *Id.*
325. *Id.*
326. Dalton v. GreatBanc Trust Co., No. 15 C 3053, 2015 U.S. Dist. LEXIS 133711 at * 7 (N.D. Ill. Oct. 1, 2015).
327. Allen v. GreatBanc Trust Co., 835 F.3d at 679–80.
328. *Id.* at 679.
329. Saumer v. Cliffs Natural Resources, Inc., 853 F.3d 855 (6th Cir. 2017).
330. *Id.* at 858.
331. *Id.*
332. *Id.* at 860.

market price.[333] While the district court had also rejected this argument, it reasoned that the only way to plead "special circumstances" was to demonstrate that Cliffs traded on an inefficient market.[334] The Sixth Circuit concluded that the "special circumstances" exception encompassed more than market inefficiency, such that it did not require the fiduciary to independently verify the accuracy of the market price.[335]

The plaintiffs also alleged that the fiduciaries should have used their inside information to prevent ESOP losses by disclosing such information to correct the market price and to direct new contributions to the plan to be held in cash, in lieu of company stock.[336] Again, the Sixth Circuit rejects this claim as falling short of the *Dudenhoeffer* standard on nonpublic-information claims.[337] In fact, the court notes that divulging inside information may have collapsed Cliff's stock price, hurting participants even more, and that closing the fund without any explanation could leave the market with insufficient information gauge the stock's true value.[338]

VII. The Jander v. IBM Exception to Stock-Drop Litigation Trends

Jander v. Retirement Plans Committee of IBM[339] provided a rare exception to the post-*Dudenhoeffer* litigation trends.[340] In direct conflict

333. *Id.* at 862 (quoting Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 413 (2014)).

334. *Saumer*, 853 F.3d at 862.

335. *Id.*

336. *Id.* at 863.

337. *Id.* at 864 (citing Harris v. Amgen, Inc., 788 F.3d 916 (9th Cir. 2014) (Harris II), Whitley v. BP, P.L.C., 838 F.3d 523 (5th Cir. 2016), and Rinehart v. Lehman Brothers Holdings Inc., 817 F.3d 56 (2d Cir. 2016), for the proposition that disclosing inside information and stopping additional ESOP contributions fail to meet the required alternative action required by *Dudenhoeffer*).

338. *Saumer*, 853 F.3d at 864 (quoting from *Harris II*, 788 F.3d at 925–26).

339. Ret. Plans Comm. of IBM v. Jander, 910 F.3d 620 (2d Cir. 2018), *vacated and remanded*, 140 S. Ct. 592 (2020), *reinstated*, 962 F.3d 85 (2d Cir. 2020) *cert denied*, 141 S. Ct. 816 (Nov. 2020).

340. Amgen Inc. v Harris, 136 S. Ct. 758 (2016); Harris v. Amgen, Inc., No. CV 07-5442, 2010 U.S. Dist. LEXIS 26283 (C.D. Cal. Mar. 2, 2010); Harris I, 738 F.3d 1026 (9th Cir. 2013); Amgen Inc. v. Harris, 134 S. Ct. 2870 (2014); Harris II, 788 F.3d 916 (9th Cir. 2014); Laffen v. Hewlett-Packard Co., 721 F. App'x 642 (9th Cir. 2018); *In re* Citigroup ERISA Litig., 104 F. Supp. 3d 599 (S.D.N.Y. 2015); Muehlgay v. Citigroup, Inc., 649 F. App'x 110 (2d Cir. 2016); Rinehart v. Lehman Brothers Holdings Inc., 817 F.3d 56 (2d Cir. 2016); Tatum v. RJR Pension Inv. Comm., et al., 855 F.3d 553 (4th Cir. 2014); Whitley v. BP, P.L.C., 838 F.3d 523 (5th Cir. 2016); Whitley v. BP, P.L.C., 575 F. App'x 341 (5th Cir. 2014); *In re* BP P.L.C. Sec. Litig., No. 10-cv-4214, 2017 U.S.

with the Fifth Circuit's *Martone* decision discussed earlier, the Second Circuit in *Jander* upheld the plaintiffs' claim that the defendants violated their ERISA duty of prudence, sufficient to survive a motion to dismiss, by continuing to hold IBM stock which they knew, based on nonpublic information, was overvalued.[341]

The plaintiffs were participants in IBM's ESOP and the defendants were fiduciaries who oversaw the retirement plan's management, as well as members of IBM's senior management.[342] IBM had been trying to locate a buyer of its microelectronics business, which had been incurring significant annual losses that IBM and its executives failed to publicly disclose, resulting in the overvalue of IBM stock.[343] The plaintiffs pleaded that the defendants should have either made an "early corrective disclosure" about the true value of the Microelectronics' business[344] or issued new investment guidelines that would have allowed the defendants to freeze continued investment in IBM stock.[345] They later amended their complaint to allege a third alternative by which the defendants could have acted upon: by acquiring hedging products to lessen further decline in the value of IBM stock.[346] The district court "found lacking" the three allegations (i.e., disclosure, halting trades of IBM stock, or buying a hedging product), deciding that each would have caused more harm than good.[347] Thus, it dismissed the case.[348]

The Second Circuit (before a panel of three judges, Chief Judge Katzmann, Judge Sack, and Judge Raggi) reversed on the following grounds:

- The plaintiffs alleged that the defendants knew that the IBM stock was overvalued as a result of accounting violations and they were aware that the Microelectronics unit was impaired, which would have affected the price of the stock.[349]

Dist. LEXIS 33302 (S.D. Tex. Mar. 8, 2017; Martone v. Robb, 902 F.3d 519 (5th Cir. 2018); Smith v. Delta Air Lines, Inc., 619 F. App'x 874 (11th Cir. 2015); Allen v. GreatBanc Trust Co., 835 F.3d 670 (7th Cir. 2016); Dalton v. GreatBanc Trust Co., No. 15 C 3053, 2015 U.S. Dist. LEXIS 133711 (N.D. Ill. Oct. 1, 2015); *Saumer*, 853 F.3d 855.

341. *Jander*, 910 F.3d at 620.
342. *Id.* at 623.
343. *Id.*
344. *Id.* at 628.
345. *Id.* at 623.
346. *Id.* at 624.
347. *Id.* (citing to Jander v. Ret. Plans Comm. of IBM, 272 F. Supp. 3d 444, 451–54 (S.D.N.Y. 2017).
348. Ret. Plans Comm. of IBM v. Jander, 910 F.3d at 620, 620 (2d Cir. 2018).
349. *Id.*

- Two of the defendants "were uniquely situated to fix this problem … as they had primary responsibility for the public disclosures that had artificially inflated the stock price to begin with."[350] Disclosure of the inflated value of the stock price could have been include in IBM's quarterly SEC filing and disclosed to the ESOP participants and beneficiaries at the same time. Such failure to disclose impaired management's credibility and impacted the viability of IBM stock as an investment because "the eventual disclosure of a prolonged fraud causes 'reputational damage' that 'increases the longer the fraud goes on.'"[351] The court noted that economic analyses mentioned by the plaintiffs supported the theory that reputational harm to the company is a predictable result of fraud, and the longer the fraud is kept secret, the greater its impact on the stock price.[352] A prudent fiduciary would not have to worry that such disclosure would unduly impact the price of the stock as it was traded in an efficient market.[353]
- In this situation, disclosure of the "longstanding company fraud" was "inevitable" as IBM was likely to sell the microelectronics unit, and, at that point, the public would be made aware of the stock's overvaluation.[354] This issue was highly relevant to the court as the typical stock drop case involves the plan fiduciary comparing only "the status quo of non-disclosure" in assessing whether the disclosure would have done more harm than good, whereas in this case non-disclosure was no longer an option.[355] Hence, when disclosure of the fraud is "inevitable," a prudent fiduciary would tend to "limit the effects of the stock's artificial inflation on the ESOP's beneficiaries through prompt disclosure."[356] The court rejected the defendants' argument that earlier corrective disclosure would not "sufficiently account for the effect of disclosure on 'the value of the stock already held by the fund.'"[357] Since disclosure of IBM's troubles was inevitable, the drop in the stock price following an earlier disclosure would not be more harmful than the drop in price following a later disclosure.[358] Thus, the court affirmed that Jander had sufficiently pleaded a complaint that no prudent fiduciary would have concluded that earlier disclosure would do more harm than good, and the

350. *Id.*
351. *Jander*, 910 F.3d at 629 (quoting the district court's case at *Jander*, 272 F. Supp. 3d at 450).
352. *Jander*, 910 F.3d at 629.
353. *Id.* at 630.
354. *Id.*
355. *Id.*
356. *Id.*
357. *Id.* at 631 (citation omitted).
358. *Id.*

ruling of the lower court is to be reversed and remanded for further proceeding.[359]

- Thus, the Second Circuit's "inevitable disclosure" theory can be summarized as follows: when "non-disclosure of IBM's troubles [is] no longer a realistic option" and "a stock-drop following early disclosure would be no more harmful than the inevitable stock drop that would occur following a later disclosure," the plaintiff has sufficiently pleaded that no prudent fiduciary could have concluded that earlier disclosure would do more harm than good.[360]

The plaintiff's triumph against IBM in *Jander* led to similar ESOP claims against Johnson & Johnson,[361] Edison International,[362] and General Electric;[363] these will be discussed in Part VIII of this Article. While there had been a decline in stock drop litigation post-*Dudenhoeffer*, the plaintiff's bar had hoped that the *Jander* exception would revive litigation, especially if the face of a market decline in which employer stock has decreased in value.[364]

Due to litigants' continued failure to meet the lofty *Dudenhoeffer* pleading standard in the district and circuit courts, the Supreme Court granted certiorari in *Jander*.[365] Plaintiffs hoped that the Supreme Court would affirm the Second Circuit's "inevitable disclosure" theory and open the door to greater stock-drop litigation.[366] The Supreme Court granted the Government's motion to take part in oral argument as an amicus curiae in support of neither party, but in order to present the

359. *Id.*
360. *Id.*
361. *See* Perrone v. Johnson & Johnson, No. 19-00923, 2021 U.S. Dist. LEXIS 36230 (D.N.J. Feb. 26, 2021).
362. *See* Wilson v. Craver, 994 F.3d 1085 (9th Cir. 2021).
363. *See* Varga v. Gen. Elec. Co., No. 18-cv-1449, 2020 WL 1064809 (N.D.N.Y. Mar. 5, 2020).
364. *See* Nevin E. Adams, *Full Court 'Press'?*, NAT'L ASS'N OF PLAN ADVISORS (Oct. 28, 2019), available at https://www.napa-net.org/news-info/daily-news/full-court-press; *see also* 29 U.S.C. § 1132(e)(2) (Providing ERISA permits the proper venue for an action to be determined as follows: (1) where the plan is administered; (2) where the breach occurred; or (3) where at least one defendant resides or is found.). *See* 29 U.S.C. § 1132(e)(2). Plaintiffs may choose to bring stock drop litigation in New York (within the Second Circuit) as it would be more likely to find a fiduciary within New York, thereby increasing the potential for successful litigation. In the case of *Smith v. Aegon Cos. Pension Plan*, 769 F.3d 922 (6th Cir. 2014), however, the Sixth Circuit affirmed the use of the plan's venue provision. This may cause more plan sponsors to select venue for any litigation outside of the Second Circuit, in order to withstand successful litigation on the part of the plaintiffs.
365. Ret. Plans Comm. of IBM v. Jander, 139 U.S. 2667 (2019) (mem.).
366. *Id.*

opinions of both the Department of Labor and the SEC.[367] In its brief per curiam decision, the Supreme Court vacated the Second Circuit's ruling.[368] The issue posed by the Court was whether *Dudenhoeffer's* "more harm than good" pleading standard is met by "generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time."[369] The Court began with a recitation of the *Dudenhoeffer* standard in the context of an alleged fiduciary breach of prudence based on inside information.[370] First, ERISA does not require the fiduciary to violate securities law in exercising its duty of prudence.[371] Second, in deciding whether the fiduciaries should halt purchasing stock on the basis of inside information or disclose inside information, courts should assess whether such action would conflict with insider trading and federal securities law disclosure requirements.[372] At the time of the *Dudenhoeffer* decision, the Court noted that it did not know the SEC's opinion on the matter.[373] And finally, the plaintiff must allege that a prudent fiduciary could not have concluded that refraining from stock purchases (which the market might view as a sign that the insider fiduciaries were acting on inside information) or disclosing negative information would do more harm than good to the fund by causing the price of the stock to drop.[374]

The Supreme Court declined to rule on the merits of the issue in *Jander*.[375] It noted that the defendants and the Government (via the SEC and DOL's amicus briefs) "focused their arguments primarily upon other matters" that previously had not been made.[376] The defendants argued that ERISA imposed no duty on fiduciaries to act on inside information, whereas the Government argued an ERISA duty to disclose insider information (not otherwise required to be disclosed under securities law) "would 'conflict' at least with 'objectives of' the 'complex insider trading and corporate disclosure requirements imposed by the

367. Ret. Plans Comm. of IBM v. Jander, 140 U.S. 398 (2019) (mem.).
368. Ret. Plans Comm. of IBM v. Jander, 140 U.S. 592, 595 (2020) (per curiam).
369. *Id.* at 594 (internal quotation and citation omitted).
370. *Id.*
371. *Id.*
372. *Id.* at 594–95.
373. *See id.* at 595.
374. *Id.*
375. *Id.* at 595.
376. *Id.* at 594–95.

federal securities laws. . .'"[377] As the Second Circuit failed to address these arguments, the case was remanded.[378]

In her concurrence, Justice Kagan (joined by Justice Ginsburg) first noted that the Second Circuit may not decide to consider the arguments raised by the Government as they were not raised in the first instance.[379] If the court, however, does choose to address such issues, the argument that ERISA imposes no duty on an ESOP fiduciary to act upon inside information squarely conflicts with the *Dudenhoeffer* decision, which made "clear that an ESOP fiduciary at times has such a duty."[380] As to the Government's argument that absent extraordinary circumstances, an ESOP fiduciary need *only* disclose inside information required by the federal securities laws, she remarks that *Dudenhoeffer* "explains 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."[381]

In his concurrence, Justice Gorsuch focused on the initial question of distinguishing between an individual's fiduciary duties versus his/her duties as a corporate officer, as the respondents seek to impose an "even *higher* duty" on fiduciaries who are in a position to order SEC-regulated disclosures.[382] He observed that *Dudenhoeffer* was silent on the question as "whether ERISA plaintiffs may hold fiduciaries liable for alternative actions they could have taken only in a nonfiduciary capacity."[383] He remarked that because ERISA holds fiduciaries 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."[384]

Upon remand, the Second Circuit (before the panel of three judges who were the same judges that held in favor of the plaintiffs in the first *Jander* decision) permitted the parties to provide supplemental briefs, including whether the court should consider arguments not previously raised before the court. It also permitted the government to supply a

377. *Id.* (quoting Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 429 (2014)).
378. *Id.* at 595.
379. *Id.*
380. *Id.*
381. *Id.* at 595–96.
382. *Id.* at 596.
383. *Id.* at 597.
384. *Id.* at 596 (citation omitted).

supplemental brief as an amicus curiae.[385] Upon its remand, the Second Circuit issued a per curiam opinion, reinstating its initial judgment.[386] As for arguments that had been previously considered, the court declined to review them; as for arguments not initially considered, the court declined to permit them.[387] Thus, the judgment of the district court remained reversed, and the case was to be remanded consistent with the Second Circuit's initial opinion.[388] On April 2, 2021, the parties settled the case of $4.75 million, which was approved by the district court in the Southern District of New York,[389] concluding six years of litigation.

385. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620 (2d Cir. 2018), *vacated*, 140 U.S. 592 (2020), *reinstated*, 962 F.3d 85, 86 (2d Cir. 2020) (Jander II), Ret. Plans Comm. of IBM v. Jander, and *cert. denied*, 141 U.S. 816 (2020) (mem.).

386. *Id.*

387. *Jander*, 962 F.3d at 86. The reinstatement of the original *Jander* decision was made by the same panel of Circuit Court Judges who heard the initial *Jander* decision in the Second Circuit (Judges Katzmann (Chief Judge), Sack, and Raggi.

388. *Id.*, *cert. denied*, *see* Ret. Plans Comm. of IBM v. Jander, 141 U.S. 816 (2020).

389. *See* Jander v. Ret. Plans Comm. of IBM, No. 15cv3781, 2021 U.S. Dist. LEXIS 136958 (S.D.N.Y. July 22, 2021).

VIII. The Aftermath of Jander

Decisions in the aftermath of *Jander* confirm that it was an outlier. In six recent decisions involving ESOPs sponsored by Target, Wells Fargo, Johnson & Johnson, General Electric, Gannett Company, and Edison Company, the federal courts have rejected the *Jander* "inevitable theory" and held that such theories fail the *Dudenhoeffer* "no more harm than good" test.

A. Eighth Circuit analysis post-Jander

In *Allen v. Wells Fargo & Co.*, the participants of Wells Fargo's ESOP sued Wells Fargo and fiduciaries of the plan for breach of their ERISA duties of prudence and loyalty by failing to disclose unethical sales methods that resulted in a decline in the price of the employer's stock.[390] As early as 2004, Wells Fargo and its senior management imposed unreasonably high sales quotas on its branch employees, which resulted in widespread illegal and unethical sales practices, including the use of confidential and personal information of its customers.[391] By 2013, the government regulators were investigating Wells Fargo's possible misconduct. The fraud was not disclosed to the public until 2016, which resulted in a drastic decline in the market value of the company stock.[392] Participants in Wells Fargo's ESOP and its 401(k) plan, which offered the Wells Fargo Stock Fund, suffered losses as a result of the stock's market decline.[393] They brought suit under ERISA against the defendants for breaches of the duties of prudence and loyalty by failing to take corrective measures to protect the plan participant, such as publicly disclosing the unethical practices, freezing investment in the employer stock, or procuring a hedging product.[394]

The district court dismissed the breach of duty of prudence complaint as it failed to plausibly allege that a prudent fiduciary could not have concluded that the proposed alternative actions would do more harm than good to the stock fund in accordance with *Dudenhoeffer*.[395] The court also dismissed the breach of duty of loyalty complaint,

390. *See* Allen v. Wells Fargo & Co., 967 F.3d 767 (8th Cir. 2020).
391. *Id.* at 770–71.
392. *Id.* at 771 (stating Wells Fargo lost more than $18 billion in market capitalization between the close of market on September 7, 2016, and September 15, 2016).
393. *Id.*
394. *Id.*
395. *Id.*

holding that, although *Dudenhoeffer* did not apply to such claim, the plaintiffs' allegations were insufficient to plausibly plead such a claim.[396]

The plan participants appealed, arguing two proposed alternative actions that the defendants could have taken: public disclosure of the unethical sales practices and freezing purchases of the Wells Fargo Stock Funds.[397] The Eighth Circuit focused on the public disclosure alternative as the defendants could not have frozen purchases of employer stock without also disclosing the unethical sales practices.[398] The court began its reasoning by acknowledging that most circuits have rejected the argument that public disclosure of negative information is a viable alternative action in an imprudence claim based on inside information.[399] It rejected the appellants' argument that, in this case, public disclosure of the fraud was inevitable, and due to general economic principles, the longer the fraud is suppressed, the greater the harm to the company and its stock price.[400] While the court acknowledged that the Second Circuit in the *Jander* decision had found that the plaintiffs had plausibly alleged that the prudent fiduciary in the defendant's position could not have concluded that earlier disclosure would do more harm than good, it rejected such argument as being "too generic" to meet the *Dudenhoeffer* standard.[401] According to the court, even if public disclosure is inevitable and could have "ameliorate[d] some harm to the company's stock price," such "course of action was not so clearly beneficial that a prudent fiduciary could not conclude that it would be more likely to harm the fund than to help it."[402] Thus, it dismissed the plaintiff's breach of duty of prudence complaint.[403]

396. *Id.* at 772.
397. *Id.* at 773.
398. *Id.*
399. *Id.* (citing Singh v. RadioShack Corp., 882 F.3d 137, 149 (5th Cir. 2018) (per curiam); Saumer v. Cliffs Nat. Res. Inc., 853 F.3d 855, 864–65 (6th Cir. 2017); Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016)).
400. Allen v. Wells Fargo & Co., 967 F.3d 767, 773–74 (8th Cir. 2020)(citing Martone v. Robb, 902 F.3d 519 (5th Cir. 2018)); *Whitley*, 838 F.3d at 529; Laffen v. Hewlett-Packard Co., 721 F. App'x 642, 644 (9th Cir. 2018) (per curiam)).
401. *Allen*, 967 F.3d at 774.
402. *Id.* at 775 (quoting from Graham v. Fearon, 721 F. App'x 429, 437 (6th Cir. 2018)).
403. *Id.* at 777.

As the plaintiffs also alleged a breach of loyalty claims (not subject to *Dudenhoeffer*), the Eighth Circuit turned to' *Twombly*[404] and *Iqbal*.[405] Those cases set forth the proper pleading for breach of loyalty claims which is to allege sufficient facts to bring about a plausible inference that the defendants breached such duty.[406] While there are numerous Eighth Circuit cases that hold the duty of loyalty mandates that a fiduciary disclose material information about the company to the plan participants if such information could adversely impact the participants' interests, such cases involve information about the plan, not about nonpublic information about the company or the company's stock.[407] In fact, if such duty did require disclosure of nonpublic information about the company or the company stock, it would circumvent the *Dudenhoeffer* standard, rendering it null and void.[408] The court also rejected the appellants' arguments that the defendants' conflicts of interest or the fact that they sold their shares of the company stock at inflated prices were insufficient to create a plausible inference that they breached their duty of loyalty.[409]

The Eighth Circuit reached a similar conclusion in *Dormani v. Target Corp*.[410] In *Dormani*, the participants of Target's ESOP sued Target and several of its senior executives alleging that they had breached their ERISA fiduciary duties of prudence and loyalty, due to the losses suffered by the ESOP in the wake of Target's expansion into Canada.[411] From March 2013 to January 2015, Target suffered losses due to the opening and closing of more than 100 Canadian stores.[412] The losses were reflected in the decline in Target's common stock price, which in

404. *See* Bell Atlantic Corp. v. Twombly, 550 U.S. 544 (2007).

405. *See* Ashcroft v. Iqbal, 555 U.S. 1030 (2008). The *Twombly* Court explain that Rule 8 of the Federal Rules of Civil Procedure require that a complaint set forth facts (in lieu of "labels" or "conclusions") that give rise to a "plausible" (as opposed to a "conceivable") claim to relief, in order to withstand a motion to dismiss. Several years later, the Court applied the *Twombly* holding to all civil suits, not just antitrust or other complex cases.

406. *Allen*, 967 F.3d at 775.

407. *Id.* at 775–76.

408. *Id.* at 776–77 (citing *In re* Pilgrim's Pride Stock Inv. Plan ERISA Litig., No. 08-cv-472, 2016 WL 8814356, at *4 (E.D. Tex. Aug. 19, 2016), ("Surely the [Supreme] Court did not lay down the detailed requirements for pleading a breach of the duty of prudence if all that was required was to label the insufficient allegations as a breach of the duty of loyalty.")).

409. *Allen*, 967 F.3d at 776–77.

410. *See* Dormani v. Target Corp., 970 F.3d 910 (8th Cir. 2020).

411. *Id.* at 913–14.

412. *Id.*

turn hurt the participants of Target's ESOP.[413] The plan participants asserted two alternative actions that the fiduciaries should have taken to protect the plan against the decline in the value of the stock: public disclosure of Target Canada's challenges or a freeze in plan purchases of the stock.[414] The Eighth Circuit again rejected the public disclosure alternative action, arguing that it was "uncertain" as to whether it would have diminished the harm.[415] It viewed such argument as "allegation[s] based on general economic principles. . . [that are] too generic to meet the requisite pleading standard."[416] Thus, the Eighth Circuit held that a reasonably prudent fiduciary could have believed disclosure "was the more dangerous of the two routes."[417]

The plan participants had also alleged that the fiduciaries violated their ERISA duty of loyalty, which requires them "to deal fairly and honestly with all plan members" and prohibits "affirmatively miscommunicat[ing] or mislead[ing] plan participants about material matters regarding their ERISA plan when discussing a plan."[418] According to the plan participants, ERISA's duty of loyalty required the fiduciaries to hire independent fiduciaries rather than "put themselves in a conflicted position by having the [Plan] hold as much Target Stock as possible to entrench management and provide other benefits to [Target]" and "plac[e] their own and/or [Target's] interests above the interests of the participants."[419] The Eighth Circuit affirmed the district court's holding that the participants failed to allege that the plan fiduciaries *knew* they were making misleading or false statement and to specify what statements were false.[420] But even if they had, the court held that the plaintiffs could not use ERISA's duty of loyalty "to circumvent the demanding *Dudenhoeffer* standard for duty of prudence claims."[421]

413. *Id.* at 914.
414. *Id.* at 915.
415. *Id.*
416. *Id.* at 915 (quoting from Allen v. Wells Fargo & Co., No. 18-2781, slip op. at 9-10 (8th Cir. July 24, 2020)).
417. Dormani v. Target Corp., 970 F.3d 910, 915 (8th Cir. 2020) (citing other circuits that have rejected this type of argument: *Allen*, slip op. at 10; Laffen v. Hewlett-Packard Co., 721 F. App'x 642, 644 (9th Cir. 2018) (per curiam); Saumer v. Cliffs Nat. Res. Inc., 853 F.3d 855, 864 (6th Cir. 2017); Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016)).
418. *Dormani*, 970 F.3d at 916 (quoting Kalda v. Sioux Valley Physician Partners, Inc., 481 F.3d 639, 644 (8th Cir. 2007)).
419. *Dormani*, 970 F.3d at 916.
420. *Id.* at 917.
421. *Id.* (quoting *Allen*, slip op. at 13).

B. District Court of New Jersey analysis post-Jander

Similarly, in *Perrone v. Johnson & Johnson*, Perrone initiated a class action breach of fiduciary duty suit on behalf of himself and the plan participants of the Johnson & Johnson ESOP against the pharmaceutical titan and its ESOP's fiduciaries, who consisted of Johnson & Johnson senior management.[422] The plaintiffs alleged that the plan's fiduciaries knew for decades that Johnson & Johnson's talc products contained asbestos, a known carcinogen, but hid such information until it was disclosed in 2018 in a Reuters article.[423] Following the damning Reuters article, Johnson & Johnson's stock price dropped more than ten percent.[424] The plaintiffs alleged that the plan fiduciaries failed to make any corrective disclosures of this negative information, even after it became inevitable that the information would become public.[425] They argued such corrective disclosure prior to the publication of the Reuters article was an alternative action that the defendants could have taken, consistent with the securities laws, and one in which no prudent fiduciary could have viewed more likely to harm the plan than to help it.[426]

The district court held that the plaintiffs failed to allege an alternate action in support of the fiduciary breach as such action would have required the individual defendants to act solely in their corporate capacity, and not in their fiduciary capacity.[427] And even if the plaintiffs had alleged an appropriate alternation action, they failed to show such course of conduct would not "do more harm than good," as they did not allege "any particularized facts" to support the assertion that earlier disclosure would have minimized the drop in the stock price.[428] The court noted that other courts have rejected generalized allegations (i.e., that the longer the concealment occurred, the greater harm to the plan) that did not satisfy the *Dudenhoeffer* standard.[429] Thus, the court granted the defendant's motion to dismiss.[430]

422. Perrone v. Johnson & Johnson, No. 19-00923, 2020 WL 2060324, at *5 (D.N.J. Apr. 29, 2020).
423. *Id.* at *2.
424. *Id.* at *3.
425. *Id.* at *4.
426. *Id.* at *4–11.
427. *Id.* at *14–17.
428. *Id.* at *19.
429. *Id.* (citing *In re* Allergan ERISA Litig., No. 17-1554, 2018 WL 8415676, at *5 (D.N.J. July 2, 2018); *In re* JPMorgan Chase & Co. ERISA Litig., No. 12 Civ. 04027, 2016 WL 110521, at *1 (S.D.N.Y. Jan. 8, 2016)).
430. Perrone v. Johnson & Johnson, No. 19-00923, 2020 WL 2060324, at *19 (D.N.J. Apr. 29, 2020).

The plaintiffs later filed an amended complaint but, again, Johnson & Johnson's motion to dismiss was granted.[431] In the amended complaint, the plaintiffs made two allegations—first, under the "corrective disclosure" theory, which would have required the defendants to make corrective disclosure of the asbestos to the public to avoid subsequent losses to the value of the company stock and second, under "cash buffer" theory, which would have required the defendants to hold incoming ESOP assets in cash until the value of the stock was no longer artificially inflated.[432] Under the corrective disclosure theory, the plaintiffs argued that the ERISA fiduciaries do have a duty to disclose nonpublic information about the plan sponsor, even if such information was obtained in the fiduciary's capacity as a corporate executive because the fiduciaries incorporated the company's securities filing into plan-related documents.[433] The court rejected such argument, stating that *Dudenhoeffer's* alternative action standard cannot force individual defendants to act in their corporate capacity in order to satisfy their fiduciary duties under ERISA.[434] In the view of the court, the "crux" of the plaintiff's alternative action remained the same—the defendants should have made corrective disclosure in the regular course of its securities filings and that making such corrective disclosure, once it became inevitable that the public would learn the truth, was the alternative action they should have taken, consistent with securities laws, and which no prudent fiduciary could have opined as more likely to harm the plan than to help it.[435]

The plaintiffs relied on two cases: *In re Schering-Plough Corp. ERISA Litig.*,[436] and *Jander I.*[437] In *Schering-Plough*, the issue was whether ERISA fiduciaries could be held liable for misstatements in certain SEC filings.[438] *Schering-Plough*, however, was clearly factually distinguishable from those in *Perrone*. In *Schering-Plough*, the court held that misrepresentations in SEC securities filings could be actionable under ERISA

431. Perrone v. Johnson & Johnson, No. 19-00923, 2021 WL 753887, at *13 (D.N.J. Feb. 26, 2021).
432. *Id.* at *2.
433. *Id.* at *4.
434. *Id.* at *5.
435. *Id.*
436. *Id.* at *6; *see In re* Schering-Plough Corp. ERISA Litig., No. Civ. A. 03-1204, 2007 WL 2374989, at *1 (D.N.J. Aug. 15, 2007).
437. *See* Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620 (2d Cir. 2018), *vacated and remanded*, 140 S. Ct. 592 (2020).
438. *In re Schering-Plough*, 2007 WL 2374989, at *6.

if the plan-related documents (e.g., summary plan description ("SPD")) incorporated them by reference.[439] Unlike that *Schering-Plough*, *Perrone* involved plan documents where the SEC filings were not incorporated by reference; the plan's summary plan description stated that copies of the plan's prospectus and other SEC filings are available to plan participants.[440] The SEC filings are incorporated by reference only in the prospectus, not the SPD, and the prospectus is not a document which ERISA requires to be disseminated to participants.[441] Thus, the SEC filings at issue could not be deemed to be fiduciary communications.[442]

The district court then noted the plaintiff's reliance on *Jander I* was misplaced as *Jander I* never answered the question of whether the alternate course of action must be one that the plan fiduciaries could have taken only in their fiduciary capacity and not their corporate capacity.[443] Hence, it reaffirmed its prior decision that a corrective SEC disclosure uncovering the truth about the overvalued company stock is not a viable alternative action because it is not one that the fiduciary could take in his/her fiduciary capacity.[444]

As to the cash buffer theory argument, the court held that pursuing such a course of action would have triggered disclosure under both ERISA and the federal securities laws.[445] As a result, a prudent fiduciary could have concluded that such disclosure would result in decline in the stock price and therefore, would have done "more harm than good."[446] Thus, the court finds such argument unpersuasive.[447] The district court again granted the defendants' motion to dismiss.

C. Ninth Circuit analysis post-Jander

In *Wilson v. Craver*, the plaintiff, Cassandra Wilson, brought a class action against the executives of Edison International Inc. ("Edison") who were fiduciaries of Edison's ESOP for retaining Edison stock, even after they knew that the stock was artificially inflated.[448] The plaintiff asserted that the defendants knew that Edison stock price was

439. *Id.* at *6–7.
440. *Id.* at *7.
441. *Id.*
442. *Id.*
443. *Id.*
444. *Id.* at *8.
445. *Id.* at *9–10.
446. *Id.* at *10.
447. *Id.*
448. Wilson v. Carter, 994 F.3d 1085, 1087 (9th Cir. 2021).

artificially inflated due to its failure to disclose to the public misrepresentations Edison had made to public regulators regarding closure of a power plant.[449] When the misrepresentations were later disclosed, the stock price declined fifteen percent.[450] The district court dismissed the complaint on the grounds that it failed to satisfy the *Dudenhoeffer* pleading standard.[451]

In applying the *Dudenhoeffer* "more harm than good" standard, the Ninth Circuit affirmed the dismissal as the plaintiff had relied upon "wholly conclusory allegations," as opposed to "context-specific allegations," as to why a prudent fiduciary could not have concluded that a corrective disclosure would do more harm than good to the stock fund.[452] The court noted that its sister circuits have all rejected the idea that general economic principles are sufficient in explaining why an earlier disclosure was "so clearly beneficial that a prudent fiduciary could not conclude that it would be more likely to harm the fund than help it."[453] Such general economic principles assert that the longer a fraud is concealed, the greater harm to the company's reputation and its stock price.[454]

The court also distinguished the facts of this case from the *Jander* decision as the facts at issue were "devoid of the 'particularly important' allegations" that were set forth in *Jander*.[455] The court concluded that even if the defendants had disclosed the misrepresentations once they became "inevitable," it was likely that it would have been "too late" to benefit the plan participants by alleviating the correction.[456] The court surmised that it was unlikely "that a corrective disclosure was so clearly beneficial at the time that a prudent fiduciary in Defendants' positions could not have concluded that it would be more likely to harm the fund than to help it."[457] Thus, the court rejected the

449. *Id.* at 1088.
450. *Id.* at 1089.
451. Wilson v. Edison Intl., Inc., 315 F. Supp. 3d 1177, 1194 (C.D. Cal. 2018), *aff'd sub nom.*, Wilson v, Craver, 994 F.3d 1085 (9th Cir. 2021).
452. *Id.* at 1092.
453. *Id.* at 1093 (citing Allen v. Wells Fargo & Co., 967 F.3d 767, 774 (8th Cir. 2020), *cert. filed*, *denied*, 141 S. Ct. 2594 (2021), No. 20-866 (U.S. Dec. 30, 2020); Martone v. Robb, 902 F.3d 519, 526-27 (5th Cir. 2018); Graham v. Fearon, 721 F. App'x 429, 436–37 (6th Cir. 2018); Loeza v. John Does 1-10, 659 F. App'x 44, 45–46 (2d Cir. 2016)).
454. *Id.* at 1093.
455. *Id.* at 1094.
456. *Id.* at 1095.
457. *Id.*

proposed alternative action which involved early public disclosure as it failed to meet the "more harm than good" test of *Dudenhoeffer*.[458]

D. Second Circuit analysis post-Jander

In the aftermath of the *Jander* decision, the Second Circuit (before a different 3-person panel of judges than in the *Jander* decision) was faced with a similar ERISA prudence complaint in the case of *Varga v. General Electric Company*.[459] Plaintiff Varga brought a putative class action against General Electric ("GE") and then-CEO Jeffrey Robert Immelt, alleging that they violated their ERISA fiduciary duties of prudence and loyalty by continuing to offer GE Stock Fund as an investment option in GE's 401(k) plan.[460] According to the plaintiffs, GE announced in 2018 that it had under reserved for the insurance liabilities of two of its subsidiaries by approximately $15 billion, causing the GE common stock price to drop.[461] Varga alleged that the defendants knew of the problem since 2009, but delayed the "inevitable" disclosure until 2018, when it would have to eventually pay the policyholder claims as they became due.[462] By not correcting their earlier false and misleading statements to plan participants regarding the financial health of GE's subsidiaries, Varga alleged that the defendants breached their ERISA fiduciary duties of prudence and loyalty.[463] Varga alleged two alternative actions that the defendants could have taken—disclose the problem earlier or close the GE Stock Fund under the 401(k) plan to additional investments after 2010.[464]

As to the first alternative action that a prudent fiduciary could not have concluded that *earlier disclosure* would do more harm than good, the district court held that there was no showing that earlier disclosure was legally viable or that the defendants concluded that it would do

458. *Id.*
459. *See* Varga v. Gen. Elec. Co., 834 F. App'x 686 (2d Cir. 2021). The panel of Second Circuit judges that presided over the *Varga* decision were Circuit Judges Kearse, Pooler, and Lynch.
460. Varga v. Gen. Elec. Co., No. 1:18-cv-1449, 2020 WL 1064809, at *1 (N.D.N.Y. Mar. 5, 2020). The allegations in the *Varga* complaint are similar to those alleged in a 2006 putative class action brought by the participant of the GE Stock Fund, within the GE 401(k) plan, in *Cavalieri v. General Electric Co.*, No. 06cv315, 2009 WL 2426001 (N.D.N.Y. Aug. 6, 2009). That lawsuit settled in 2009.
461. *Varga*, 2020 WL 1064809, at *1.
462. *Id.* at *2.
463. *Id.*
464. *Id.* at *3.

more harm than good.[465] The court distinguishes the facts in this case with *Jander*, where the fact that the defendant company (IBM) was going to be sold was a "particularly important" assertion, because "a potential purchaser's due diligence would likely result in discovery of the business's problems," and thus, disclosure of the company's overevaluation was inevitable.[466] In contrast, Varga failed to assert a similar "major triggering event" that would have made GE's disclosure inevitable.[467] As to the second alternative action that the defendants could have closed the GE stock fund to additional investment after 2009, such allegation is:

> "speculation—not a factual allegation" such that a prudent fiduciary could have concluded that such alternative would do more harm than good.[468] Thus, the district court granted the defendants' motion to dismiss as the plaintiff's complaint failed to meet the *Dudenhoeffer* pleading standard, as the alternative actions were inadequate to show that the fiduciaries "could not have concluded. . . would do more harm than good."[469]

On appeal to the Second Circuit, Varga argued that the two alternative actions that the defendants could have taken satisfied *Jander*, and thus, her complaint should have survived a motion to dismiss.[470] As to Varga's claim that disclosure was inevitable, the court held that Varga failed to allege "any similar major triggering event" to the impending sale in *Jander* that would have made GE's disclosure inevitable; instead, Varga merely alleges "that since other insurers with under-funded long-term care liabilities 'inevitably' had to disclose their problems, GE would have to as well."[471]

Similarly, as to Varga's second alternative action that the fiduciaries could have closed the fund in 2009, such action is "similarly conclusory, unsupported by an factual matter suggesting that the fiduciaries could not have concluded that such an action would do more harm

465. *Id.* at *4 (citing *In re* JPMorgan Chase & Co. ERISA Litig., No. 12 Civ. 04027, 2016 WL 110521, at *4 (S.D.N.Y. Jan. 8, 2016), which rejected the earlier disclosure argument on the basis that the longer the fraud continues, the more harm continues because "[t]hese assertions are not particular to the facts of this case and could be made by plaintiffs in any case asserting a breach of ERISA's duty of prudence").

466. *Varga*, 2020 WL 1064809 at *5, n.3 (citing from Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 630 (2d Cir. 2018)).

467. *Varga*, 2020 WL 1064809, at *5.

468. *Id.* at *4.

469. *Id.* at *3–4.

470. Varga v. Gen. Elec. Co., 834 F. App'x 686, 688 (2d Cir. 2021).

471. *Id.* (quoting from Varga, 2020 WL 1064809, at *4 n.3).

than good."[472] Thus, the Second Circuit affirmed the district court's dismissal of Varga's claim, signaling that the "inevitable theory" has its shortcomings, even in the Second Circuit.[473] The decision indicates that the facts in the case, not the *Dudenhoeffer* standard, made it distinguishable from the *Jander* decision.[474] This, however, provides little guidance to ESOP fiduciaries as to how to avoid future litigation, other than documenting the *lack* of any "major triggering events" that would have made disclosure inevitable.

In summary, with respect to *Dudenhoeffer's* standard that the breach of fiduciary claim was based on publicly available information (i.e., the public-disclosure argument), the federal courts have yet to enunciate what amounts to "special circumstances," making it difficult for plaintiffs to survive a motion to dismiss on this claim. With respect to the *Dudenhoeffer's* second standard to allege a breach of fiduciary claim on the basis of inside information (i.e., the plaintiffs must allege an alternative action the defendant could have taken, consistent with securities laws, and would not have been viewed by the defendant to cause more harm to the fund than good), the circuits have rejected the plaintiff's arguments that public disclosure of negative information is a viable alternative action as a prudent fiduciary could have concluded that disclosure would do more harm than good "by causing a drop in the stock price and a concomitant drop in the value of the stock already held be the fund."[475] Such allegations are based on general economic principles that "the longer the fraud persists, the harsher the correction tends to be, usually because a prolonged fraud necessarily means that long-term damage is also done to a fraudster's reputation for trustworthiness."[476] Only a panel of three judges in the Second Circuit has concluded that a prudent fiduciary would have made earlier disclosure, as compared to later disclosure, when the drop in the stock price held by the fund is inevitable, so as to limit the effect on the stock price.[477] The

472. *Varga*, 834 F. App'x at 688.
473. *Id.* at 689.
474. *Id.* at 688.
475. Singh v. RadioShack Corp., 882 F.3d 137, 149 (5th Cir. 2018) (per curiam) (quoting Dudenhoeffer, 573 U.S. at 430). *See, e.g.*, Saumer v. Cliffs Natural Res. Inc., 853 F.3d 855, 864 (6th Cir. 2017); Whitley v. BP, P.L.C., 838 F.3d 523, 529 (5th Cir. 2016) (holding "that a prudent fiduciary could very easily conclude that [disclosure of such information] would do more harm than good"); Allen v. Wells Fargo & Co., 967 F.3d 767, 773 (8th Cir. 2020).
476. Martone v. Robb, 902 F.3d 519, 526-27 (5th Cir. 2018).
477. Jander v. Ret. Plans Comm. of IBM, 910 F.3d 620, 630 (2d Cir. 2018).

other circuits have rejected this argument that allegations of inevitable disclosure and increasing harm over time, as they fail the "no more harm than good" test.[478] In response, plaintiffs have attempted to allege that the defendant's correction disclosure should have been made in the course of the regular securities filings with the SEC (e.g., annual or quarterly reports).[479] They have also attempted to buttress their allegations with expert reports or testimony at the pleading stage.[480] But such efforts have not succeeded.[481] Thus, the *Dudenhoeffer* dual standards appear to be formidable for the plaintiff's bar to prevail. While there was a glimmer of hope that the Supreme Court would clarify whether the *Jander* inevitable theory could withstand a motion to dismiss, it left that question open for another day. In the meantime, the majority of the federal circuit courts continue to be defendant friendly in dismissing stock drop litigation.

IX. How do employers and ESOP fiduciaries avoid future litigation

It is clear from the *Dudenhoeffer* pleading standard that the Supreme Court does not wish to weigh-in on plan governance issues, including how and when an ESOP fiduciary should buy and sell employer stock in a volatile financial market.[482] *Dudenhoeffer* considers claims based on public information (thereby requiring "special circumstances" to be alleged in order to overcome this standard) or claims based on nonpublic information (thereby requiring an alternative action to be alleged, consistent with securities law, whereby a prudent fiduciary could not have concluded that such action would do more harm than good).[483] The *Jander* "inevitable disclosure" theory, caveating the second nonpublic claim appears to be an outlier in most circuits, including a panel of judges within the Second Circuit.[484]

478. *See, e.g.*, Dormani v. Target Corp., 970 F.3d 910, 916 (8th Cir. 2020); Allen v. Wells Fargo & Co., 967 F.3d 767, 773 (8th Cir. 2020); Perrone v. Johnson & Johnson, No. 19-00923, 2020 WL 2060324, at *11 (D.N.J. Apr. 29, 2020); Varga v. General Electric Co., 834 Fed. Appx 686, 688 (N.D.N.Y. 2021).

479. Perrone v. Johnson & Johnson, No. 19-00923, 2020 WL 2060324, at *11 (D.N.J. Apr. 29, 2020).

480. *In re* BP P.L.C. Securities Litigation, 2017 WL 914995 (S.D. Tex. Mar. 8, 2017).

481. *See, e.g.*, Burke v. Boeing Co., 2020 WL 6681338, at *4–5 (N.D. Ill. Nov. 12, 2020).

482. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 428–30 (2014).

483. *Id.*

484. *See, e.g.*, Wilson v. Craver, 994 F.3d 1085, 1094–96 (9th Cir. 2021).

While none of the lower courts have thus far outlined the "special circumstances" necessary for purposes of successfully pleading a breach of fiduciary claim of prudence based on public information, the plaintiffs' bar will become more skillful in crafting such circumstances, so as to survive a motion to dismiss. The standard, however, to assert a breach of fiduciary claim of prudence based on nonpublic information appears to be an impossible standard for the plaintiffs' bar to meet. As made clear by the Eighth Circuit in *Braden*—which did not involve stock drop litigation, but a similar breach of fiduciary claim for excessive fees—ERISA plaintiffs tend to simply lack "the inside information necessary to make out their claims in detail unless and until discovery commence."[485] This remains true in stock drop litigation in which the ESOP fiduciary may be privy to inside information. Thus, fashioning alternative actions the ESOP fiduciary should have taken, consistent with securities law, may be an impossible task as the plaintiffs are not privy to the actions that a fiduciary could have taken advantage of and still not inflict more harm than good on the plan participants. As a result, stock drop litigation continues to be extremely defendant friendly, despite the lasting effects of drop in stock price for participants and beneficiaries, who are often dependent on the health of the stock for retirement.[486] Given the more pressing problems facing the current Congress, it is highly unlikely that it will take on the challenge and impose more protections for plan participants and beneficiaries in stock drop litigation.[487]

Another litigation issue that plaintiff may consider in stock drop litigation is ERISA's venue provisions. It provides a liberal venue provision in the context of breaches of fiduciary duty, allowing lawsuits to be brought in any venue "in the district where the plan is administered, where the break took place, or where a defendant resides or may be found."[488] Hence, defendants should not be surprised to see plaintiffs bringing ERISA lawsuits in the courts within the Second Circuit (which include the states of Connecticut, New York, and Vermont) where the inevitable theory has gained traction. Thus, if a defendant can be

485. Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 598 (8th Cir. 2009).

486. *See, e.g.*, Joseph P. Yonadi Jr., *ESOPs, Stock-Drop Litigation and Jander*, OHIO STATE BAR ASS'N (July 20, 2020), https://www.ohiobar.org/member-tools-benefits/practice-resources/practice-library-search/practice-library/section-newsletters/2020/esopss-stock-drop-litigation-jander/ (describing the *Jander* plaintiffs' victory as a "Rare Stock-Drop Win for ERISA Plaintiff Attorneys").

487. *But see* S. 1559, 117th Cong. (2021).

488. 29. U.S.C. § 1132(e)(2).

"found" in New York, the plaintiff is likely to bring suit within the federal courts in New York in order to apply the Second Circuit's more plaintiff-friendly interpretation of the more-harm-than-good standard.

Regardless of congressional appetite for action, there are practical steps that ESOP or 401(k) ESOP plan creators should take in order to avoid stock-drop litigation. ESOP fiduciaries should recall the early DOL Information Letters that stressed strict procedural prudence when such fiduciaries decide to purchase employer stock and to finance the ESOP loan.[489] The ESOP fiduciaries should properly document its decision-making process in procuring employer stock and its monitoring to continue to hold on to employer stock, including a *lack* of "special circumstances" needed for one of the two *Dudenhoeffer* standards. While the use of independent financial and legal counsel is advised, the ultimate responsibility for the decisions regarding the ESOP lie with its fiduciary.[490] Thus, as an overarching consideration, employers sponsoring ESOPs or 401(k) ESOP plans should always focus on developing effective and thorough plan governance protocols.[491] The courts determine whether a fiduciary has breached his or her duty of prudence based on the *process* by which he or she made his or her decisions, not the actual results of such decisions.[492] With respect to the plan's investment strategy, the first issue is to determine who will sit on the plan's investment committee, as those individuals will be deciding whether to hold or sell employer stock in the event of a market decline. If the employer wishes to maintain total control in choosing the plan investment committee, it should avoid putting officers or executives, inside legal counsel, or any other board member or individual who may be privy to nonpublic information. Therefore, choosing personnel one level below the executive-level managers may be the answer, so long as the chosen individuals do not effectively become "stand-ins" for their superiors.

Another issue for ESOP plan creators is whether to insert or retain language in the plan document requiring the fiduciary to hold

489. *See* DOL Information Letters to Gareth W. Cook (Sept. 12, 1983) (on file with author); DOL Information Letters to Charles R. Smith (Nov. 23, 1984) (reprinted in 12 PENS. & BENS. REP. 52); DOL Information Letters to Wilson H. Ellis, Jr. (July 30, 1985), (reprinted in 12 PENS. & BENS. REP. 52).

490. *See* 29 C.F.R. § 2550.404a-1 (2020).

491. *See generally Corporate Governance For Private ESOP Companies*, EMPLOYEE BENEFITS LAW GROUP (Feb. 8, 2017), https://www.employeebenefitslawgroup.com/corporate-governance-for-private-esop-companies-full-article/.

492. *See* Roth v. Sawyer-Cleator Lumber Co., 16 F.3d 915, 917–18 (8th Cir. 1994); Schaefer v. Ark. Med. Soc'y, 853 F.2d 1487, 1492 (8th Cir. 1988).

employer stock.[493] ERISA requires a plan fiduciary to follow the terms of the plan, but only to the extent such terms are consistent with ERISA.[494] The Supreme Court in *Dudenhoeffer* was clear that ERISA's duty of prudence "trumps the instructions of a plan document, such as an instruction to invest exclusively in company stock."[495] Having the plan document explicitly require the plan fiduciary to hold employer stock within the ESOP buttresses the fiduciary's argument that it is following the terms of the plan, consistent with ERISA's prudence requirements.[496]

Another issue for consideration is how the plan fiduciaries will monitor the retention of employer stock within the ESOP. The goal is to determine what "special circumstances" that the *Dudenhoeffer* Court alluded to that would trigger reliance on the market's price of the employer stock as being unreliable.[497] Some examples of what could trigger "special circumstances" include: a rating agency's (e.g., Moody's or S&P) warning regarding the employer's credit worthiness; a special pronouncement from the SEC or the plan auditor reflecting upon the financial health of the employer; and the employer's auditor issuing something other than an unqualified opinion.[498] Whatever the "special circumstances" the employer chooses to focus on, well-documented fiduciary meeting minutes and other corporate records should reflect the fiduciary's deliberation on the issue of retaining or selling employer stock in the event of the stock price dropping.

Additionally, an ESOP fiduciary should consider invoking a company stock monitoring policy, which may or may not be a part of the plan's investment policy statement ("IPS"). Such a monitoring policy would not be designed to unduly limit the ESOP fiduciary's actions, but instead highlight those special circumstances that may require a heightened level of review of the company's stock. As such, the monitoring policy should provide flexibility for the fiduciary to exercise his/her discretion in light of pre-specified review-triggering events.

While ERISA allows an ESOP fiduciary to wear two hats—one of fiduciary and another of corporate settlor—the use of an *independent*

493. *See, e.g.*, Yonadi Jr., *supra* note 486 (noting that "[a]n ESOP fiduciary may utilize the ESOP plan document as a shield if such document incorporates language requiring employer contributions to be invested in employer stock.").
494. 29 U.S.C. § 1104(a)(1)(D) (2019).
495. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 421 (2014).
496. *See generally* Yonadi Jr., *supra* note 486.
497. *Dudenhoeffer*, 573 U.S. at 413.
498. *See generally id.* at 426.

fiduciary for the ESOP may solve many of these problems. As the independent fiduciary would not be involved with other corporate duties, he or she would wear only one hat—that of the fiduciary. This would also address the stock-monitoring issue by having the independent fiduciary in charge of all aspects of the ESOP. The appointment can take on many shapes and forms—an independent fiduciary many have limited scope (e.g., he or she simply serves as an advisor to the fiduciary committee) or broader scope (e.g., full discretionary power including decisions surrounding the sale/purchase of employer stock). The degree of authority the independent fiduciary would have may depend on factors such as the volatility of the employer stock within its industry and market.

The advantages of an independent fiduciary with full discretionary powers include:

- The company would be exposed to less risk of stock-drop litigation, especially if the claim is based on inside knowledge, as the independent fiduciary is wearing only one hat—that of the fiduciary—and is not privy to any nonpublic information.
- The company would have less oversight responsibility in monitoring the company stock as the independent fiduciary would ideally be given that authority. Of course, the employer would still be responsible for monitoring its appointed independent fiduciary.
- Corporate executives, who otherwise would have been named as plan fiduciary, would be less distracted, especially at a time that involves corporate emergencies that traditionally give rise to stock drop litigation.
- Hiring independent plan fiduciaries acts as an insurance policy in the event of a corporate emergency impacting the company stock. Although hiring an independent fiduciary may be expensive, in the event the company needs the protection afforded by an independent fiduciary in the face of negative or sudden corporate event, it's worth every penny.

The disadvantages of an independent fiduciary include:

- The expense of the independent fiduciary's fees.
- The company has less control over the fiduciary's action, which could be problematic if the company is in a less volatile industry.
- There are additional administrative concerns (e.g., the independent fiduciary must participate in the minutes).
- In the event the company wishes to terminate its independent fiduciary's contract, the company will have to do so carefully so that it does not appear that the company is in search of a more pliant independent fiduciary.

What is the future of ESOP plans? They are definitely not going away, especially in the context of the S-Corporations, where ESOPs have become entrenched.[499] The late Senator Ted Kennedy proposed legislation to permit ESOPs, but only, if they were supplemental on top of a base 401(k) plan, sponsored by the employer, so that the ESOP was not the sole form of retirement income for the participant.[500] That legislation went nowhere, and there is little appetite in the current Congress to alter ERISA's rules as they pertain to ESOPs.[501]

Shareholders of publicly traded corporations receive voting rights when they purchase their stock, affording them the right to voice their concerns on corporate matters. According to one study, institutional investors—such as mutual funds, index funds, pensions, and hedge funds—own seventy percent of the outstanding shares of publicly traded corporations in the United States, thereby granting them a major influence in voting outcomes.[502] There are a variety of proxy advisory firms that make recommendations to institutional investors as to how they should vote their shares in order to effectuate corporate change and outcomes.[503] It remains to be seen whether proxy advisors such as Glass Lewis & Co. and/or ISS will add to their list of "best practices," the use of independent fiduciaries within an ESOP as a way to stem future litigation and to provide greater protection for plan participants and beneficiaries. If that becomes the case, it won't be the first-time

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499. According to the National Center for Employee Ownership in Oakland, CA, as of 2018, there are 6,501 ESOPs in the United States (of which 90% are with privately held companies), holding total assets of over $1.4 trillion and covering over 14 million participants. There are also over 4,000 qualified retirement plans that are "ESOP-like" in that they are substantially (at least 20%) invested in employer stock and have at least 5 participants. C Corporations are subject to federal income taxes both at the corporate level and shareholder level. In contrast, S Corporations do not pay taxes at the corporate level, as their shareholders are subject to taxation based on their prop rata share of the S Corporation's taxable income. An ESOP is a tax-exempt trust and thus is not subject to federal income tax on its share of the S Corporation's taxable income. Hence, if an S Corporation is owned 100% by an ESOP, it will owe no taxes on its otherwise taxable income. *See* The ESOP Association, *ESOP Brief #3, Tax Advantages for Business Planning*, ESOP, https://esopassociation.org/sites/tea-master/files/2019-12/esop-brief-3-final.pdf.

500. *See generally* S. Rep. No. 107-226 (2002).

501. *But see* S. 1559, 117th Cong. (2021).

502. *2020 Proxy Season Review*, ProxyPulse (2020), available at https://proxypulse.broadridge.com.

503. *See* David F. Larcker, "The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry," Harvard Law School Forum on Corporate Governance, available at https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry.

federal securities law principles come to the aid of ERISA plan participants and beneficiaries.[504]

X. Conclusion

Stock drop litigation has generated a considerable amount of litigation since ERISA's passage. It highlights the tension in ERISA with promoting ESOPs which can invest primarily in employer stock with its duty of prudence in the context of employer stock falling in value. While the majority of circuits affirmed the Third Circuit's *Moench* presumption which extended a presumption that an ESOP fiduciary had not breached its fiduciary duty of prudence from 1995 until 2014, the Supreme Court in the *Dudenhoeffer* decision imposed a new two-part pleading standard in order for the plaintiffs to withstand a motion to dismiss: (1) if the breach of fiduciary claim was based on publicly available information, the plaintiffs must allege "special circumstances" (a term undefined by the Court) as to why the market price was unreliable or (2) if the breach of fiduciary claim was based on nonpublic inside information, the plaintiffs must allege that the fiduciary should have taken an alternative course of action, consistent with securities law, after it concluded that such alternative action would not have done more harm than good to the plan's funds. These standards have proven far more rigorous that the pleading standard required in a garden-variety breach of fiduciary duty claim, as seen in litigation involving the underperformance of investment funds offered by the fiduciary to the plan participants and/or the reasonableness of the fees assess by such

504. Former U.S. Secretary of Labor Thomas Perez wished to make changes in the financial world regarding the standards of care that financial advisers were subject to in their dealings with ERISA plans and IRAs. As a result, the DOL rolled out in 2015 proposed regulations redefining who was an investment advice fiduciary for purposes of Title I of ERISA and the Code's prohibited transaction rules. These were finalized in 2016 and subjected broker/dealers and their registered representatives to a new "best interest" standard, in lieu of the "suitability" standard applicable to them under securities law. The regulations also adopted from securities law that that broker/dealers eliminate and mitigate all conflicts of interests. They adopted securities laws' notion that advising a plan participant on his/her ability to roll monies into an IRA was an investment recommendation. The final regulations were ultimately vacated by the Fifth Circuit Court. In the wake of the vacated regulation, the SEC issued Regulation BI (Release No. 34-83062) which invoked a "best interest" standard of care applicable to broker/dealers when making investment recommendations. *See* Kathryn J. Kennedy, "The DOL Final Fiduciary Regulations and Related Prohibited Transaction Exemptions," 2016 NYU REV. EMPLOYEE BENEFITS & EXEC. COMP. CH.-2 (Fall 2016).

investment funds. Since 2014, the *Dudenhoeffer* pleading standards, in the context of stock drop litigation, have proven to be extremely defendant friendly. While the plaintiffs' bar had a glimmer of hope with the 2018 *Jander* decision out of the Second Circuit, the Supreme Court in taking *certiorari* in the decision declined to rule on the merits of that decision, leaving it to another day to rule on this issue. In the meantime, the majority of circuits, including a three-person panel in the Second Circuit, have declined to invoke *Jander's* inevitable disclosure theory, thus, affirming the *Dudenhoeffer* standards as imposing an insurmountable hurdle for the plaintiffs' bar. There are, however, a host of ways that an employer and/or ESOP fiduciaries can avoid future stock drop litigation, including appointing an independent ESOP fiduciary.