

SECOND CIRCUIT OVERRULES DISTRICT COURT DISMISSAL OF STOCK-DROP CASE

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In a significant departure from the stock drop case rulings coming out of other courts, including other U.S. Courts of Appeals, the U.S. Court of Appeals for the Second Circuit overturned a district court's dismissal of a claim for breach of ERISA fiduciary duties brought by a participant whose accounts in IBM's 401(k) plan were invested in an IBM stock fund and suffered losses as a result of a decline in the market price of IBM shares. Prior to this Second Circuit ruling, plaintiffs in other stock drop cases have struggled to defeat plan defendants' motions to dismiss.

The plaintiff in this case alleged that plan fiduciaries knew or should have known that IBM's microelectronics division was overvalued, and then failed to disclose that fact to plan participants. That failure, according to the plaintiff, artificially inflated IBM's stock price, and ultimately resulted in a \$12 share price drop when IBM had to pay \$1.5 billion to sell the struggling microelectronics division and also had to take a \$4.7 billion pre-tax charge that in-part reflected an impairment in the stated value of the microelectronics business. Among other things, the plaintiff alleged that the plan fiduciaries knowledge of undisclosed financial trouble for the microelectronics division violated the ERISA fiduciary duty of prudence. The district court (i.e., the federal trial court), however, dismissed the claim, based on pleading standards prescribed by the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, because the plaintiff's pleadings lacked allegations sufficient to demonstrate that a prudent fiduciary could not have determined that each of the plaintiff's proposed alternative actions for avoiding an ERISA breach (for example, making public disclosures or halting the plan from making further investments in IBM stock) might have caused more harm than good.

On appeal, the Second Circuit disagreed with the district court, and concluded that the plaintiff plausibly pleaded that the plan defendants violated the fiduciary duty of prudence. The Second Circuit devoted some attention to assessing the *Dudenhoeffer* "more harm than good" pleading standard, which is susceptible to multiple interpretations. But, the Second Circuit ultimately declined to decide which interpretation is correct, and instead ruled that the plaintiff plausibly pleaded a duty of prudence claim even under a more restrictive application of the "more harm than good" standard. The Second Circuit identified several allegations in the plaintiff's amended complaint that "plausibly establish that a prudent fiduciary in the IBM plan defendants' position could not have concluded that [early] corrective disclosure

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[of the microelectronics division’s impairment] would do more harm than good,” including allegations that the plan defendants knew the IBM stock was artificially inflated, that the Plan defendants had the power to disclose the truth to the public and correct the artificial inflation, that failure to promptly disclose the actual value of the microelectronics division hurt the long-term prospects of IBM stock as an investment due to reputational harm that could lead to greater stock drops, that a prudent fiduciary need not fear overreaction by the market to disclosure of the microelectronics division’s impairment because IBM stock is traded in an efficient market, and that disclosure of the truth regarding IBM’s microelectronic business was inevitable. Thus, the Second Circuit reversed the district court’s grant of the defendant’s motion to dismiss the complaint, and remanded the case for further proceedings.

The rarity of this type of victory for plaintiffs in a stock drop case is particularly noteworthy, and potentially signals future opportunities for plaintiffs in stock drop cases to survive a plan defendant’s motion to dismiss. In the meantime, this case warrants further monitoring – the case certainly is not over and further appeals, perhaps even to the Supreme Court, will need to play out before the influence of this decision on future stock drop cases can be fully assessed. *Jander v. IBM* (2nd Cir. 2018).