No. 18-1165

In the
Supreme Court of the United States

RETIREMENT PLANS COMMITTEE OF IBM, et al.,
Petitioners,

v.

LARRY W. JANDER, et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR PETITIONERS

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QUESTION PRESENTED

In *Fifth Third Bancorp v. Dudenhoeffer*, this Court unanimously held that to state a claim under the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. §1001 *et seq.*, for breach of the fiduciary duty of prudence based on inside information, a plaintiff must "plausibly allege[] that a prudent fiduciary in the defendant's position could not have concluded that [an alternative action] would do more harm than good to the fund." 573 U.S. 409, 429-30 (2014); *accord Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016). The Court designed this "context specific" standard to deter the kind of meritless suits lower courts had eliminated through a presumption of prudence (which the Court rejected) and to "readily divide the plausible sheep from the meritless goats" at the pleading stage. 573 U.S. at 425.

In the decision below, the Court of Appeals subverted that pleading standard and opened a circuit split by relying on boilerplate allegations that the harm of an eventual disclosure of an alleged fraud typically increases the longer the fraud continues. Those allegations always can be, and routinely are, pleaded in support of a *Dudenhoeffer* claim. Other courts of appeals have rejected the same allegations as insufficient as a matter of law, in order to avoid undermining the pleading standard imposed by *Dudenhoeffer* and *Amgen* and to deter meritless ERISA suits. The question presented is:

Whether *Dudenhoeffer*'s "more harm than good" pleading standard can be satisfied by generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time.

PARTIES TO THE PROCEEDING

Petitioners Retirement Plans Committee of IBM, Richard Carroll, Martin Schroeter, and Robert Weber were defendants in the district court and appellees in the Second Circuit. Respondents Larry W. Jander and Richard J. Waksman were plaintiffs in the district court and appellants in the Second Circuit. International Business Machines Corporation ("IBM") was initially named as a defendant in the district court, but was dropped from respondents' second amended complaint and did not participate in the proceedings in the Second Circuit.

CORPORATE DISCLOSURE STATEMENT

No petitioner is a corporation. IBM, which was dropped from respondents' second amended complaint in the district court and did not participate in the proceedings in the Second Circuit, has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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INTRODUCTION

In *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014), this Court recognized the risk that plaintiffs would bring meritless and economically burdensome ERISA suits against plan fiduciaries overseeing an employee stock ownership plan ("ESOP") whenever the company's stock price dropped. That risk would undermine Congress' clear intent to encourage ESOPs and the benefits they provide for employers and employees alike. To protect against that risk and "weed out meritless lawsuits," *Dudenhoeffer* instructed the lower courts to apply "careful, context-sensitive scrutiny" to such complaints to determine whether they state a plausible claim. *Id.* at 425. In particular, when a plaintiff asserts that ESOP fiduciaries should have made a different fiduciary decision based on inside information, the complaint must plausibly allege facts showing that "a prudent fiduciary in the defendant's position could not have concluded that" the alternative action, such as disclosing the inside information, "would do more harm than good to the fund." *Id.* at 428-30; *accord Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016).

This case presents precisely the sort of suit that *Dudenhoeffer* sought to foreclose. Respondents alleged that petitioners—IBM executives who are also fiduciaries of IBM's ESOP—violated the duty of prudence when they failed to disclose inside information that, when eventually disclosed to the market, caused a drop in IBM's stock price. Although a prudent fiduciary could have readily concluded that early disclosure of such inside information with the

concomitant immediate drop in the stock price would do more harm than good to the fund, the Second Circuit allowed the suit to proceed based on generic allegations that disclosure was inevitable and disclosure sooner-rather-than-later is always the prudent course.

That decision departed from the sensible approach of other circuits and cannot stand. Respondents' suit fails at the threshold because it is premised upon a supposed duty of insider fiduciaries to take inside information gathered in their corporate capacity and use it in their fiduciary capacity to benefit plan participants. But no such duty exists. Congress deliberately authorized corporate officers to serve as plan fiduciaries, and this Court has made clear that those two capacities are distinct. When corporate officers act in their corporate capacity, their duties are to all shareholders, not to the subset who are ESOP participants. And when insider fiduciaries put on their fiduciary hats, there is no obligation to use information gained in a different capacity for the exclusive benefit of plan participants. There is an entire regulatory regime designed to regulate the timing and scope of disclosures of corporate information by corporate officers. Superimposing a judge-made ERISA disclosure regime on the subset of corporate officers who serve as plan fiduciaries has nothing to recommend it.

But even assuming that insider fiduciaries have an obligation to use nonpublic corporate information to benefit ESOP participants, that only underscores the importance of requiring plausible allegations that nondisclosure was imprudent. The pleading standard

this Court articulated in *Dudenhoeffer* does just that by requiring a plaintiff to point to a specific alternative course and to plausibly allege that a prudent fiduciary "could not have concluded" that the alternative "would do more harm than good to the fund." 573 U.S. at 430. That standard follows directly from the text and structure of ERISA, which recognize that often there are a range of prudent options, and a fiduciary does not act imprudently or incur personal liability by pursuing one of those prudent options.

Applying that standard, this should have been an easy case. Petitioners had to balance the immediate and certain harm of an early and extraordinary disclosure to plan participants with extensive holdings against the uncertain effects of later disclosure on newer employees just building a position in IBM stock. Petitioners' decision to not inflict immediate and certain losses through early disclosure of a not-yet-consummated transaction and related financial information was hardly a decision no prudent fiduciary could make. Indeed, given that the ESOP was a net seller of IBM stock, avoiding immediate losses to the fund was likely the most prudent course. The complaint's contrary allegations depend on generic allegations that no fraud lasts forever and disclosure sooner-rather-than-later is always prudent. But those allegations could be made in any case, and fall far short of *Dudenhoeffer* and *Amgen*'s demand for specific allegations that separate valid claims from meritless ones. Applying those decisions faithfully, as the Fifth and Sixth Circuits did in confronting materially identical allegations by the same attorney, leads to only one outcome: Respondents' complaint must be dismissed.

OPINIONS BELOW

The Second Circuit's opinion is reported at 910 F.3d 620 and reproduced at Pet.App.1a-24a. The district court's opinion is reported at 272 F. Supp. 3d 444 and reproduced at Pet.App.25a-44a.

JURISDICTION

The Second Circuit issued its opinion on December 10, 2018, and denied a timely petition for rehearing en banc on January 18, 2019. A timely petition for certiorari was filed on March 4, 2019, and granted on June 3, 2019. This Court has jurisdiction under 28 U.S.C. §1254(1).

STATUTORY PROVISIONS INVOLVED

The relevant provisions of ERISA, 29 U.S.C. §1001 *et seq.*, are reproduced in the appendix.

STATEMENT OF THE CASE

A. Legal Background

1. ERISA is a "comprehensive and reticulated statute" that imposes numerous federal requirements on employee retirement plans established by private companies. *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 251 (1993). In addition to "specifying certain plan characteristics in detail," *Varity Corp. v. Howe*, 516 U.S. 489, 496 (1996), ERISA "establish[es] standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans," 29 U.S.C. §1001(b). In particular, ERISA imposes a duty of prudence on plan fiduciaries, requiring them to act "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." *Id.* §1104(a)(1)(B). The statute authorizes plan participants to sue fiduciaries who breach their duties, and makes those fiduciaries personally liable for any losses to the plan resulting from any such breach. *Id.* §§1109(a), 1132(a)(2)-(3).

One specialized type of retirement plan covered by ERISA is an ESOP, which is a retirement plan that "invests primarily in the stock of the company that employs the plan participants." *Dudenhoeffer*, 573 U.S. at 412; *see* 29 U.S.C. §1107(d)(6). As *Dudenhoeffer* observed, "Congress sought to encourage the creation of ESOPs," 573 U.S. at 424, and adjusted the basic requirements of ERISA to accommodate their unique characteristics. As a general matter, ERISA requires plan fiduciaries, as part of their duty of prudence, to "diversify[] the investments of the plan so as to minimize the risk of large losses." 29 U.S.C. §1104(a)(1)(C). The *raison d'être* of an ESOP, however, is to facilitate investment in a single stock (the participants' employer), and Congress therefore gave ESOPs an express statutory exception from the general diversification requirement, providing that for ESOPs "the diversification requirement … and the prudence requirement (only to the extent that it requires diversification)" are "not violated by acquisition or holding of … qualifying employer securities." *Id.* §1104(a)(2); *see also id.* §1107(b)(1) (exempting ESOPs from the requirement that employer stock cannot constitute more than 10% of an ERISA plan's total value).

That exception is just one of many ways in which Congress has encouraged ESOPs. "[I]n a series of laws," Congress "has made clear its interest in encouraging [ESOPs] as a bold and innovative method of strengthening the free private enterprise system." *Dudenhoeffer*, 573 U.S. at 416 (second alteration in original) (quoting Tax Reform Act of 1976, Pub. L. No. 94-455, §803(h), 90 Stat. 1521, 1590). Congress recognized that by stimulating employees to invest in their employers, ESOPs "solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees," while promoting increased retirement savings and improving employee morale and productivity. *Id.* (quoting 90 Stat. at 1590); *see* S. Rep. No. 101-384, at 209 (1990) ("ESOPs encourage the growth of employee ownership in the United States and, with it, a broader base for acquiring capital, increased competitiveness, and a renewal of the entrepreneural [sic] spirit in America."); Corey Rosen, *Do ESOPs Need Reform?*, 147 Tax Notes 1465, 1466 (2015) (noting that companies with ESOPs contribute more on average to those plans than other companies contribute to non-ESOPs). Given Congress' view that ESOPs have numerous advantages that include, but go beyond, retirement savings, Congress has specifically warned against "regulations and rulings 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." *Dudenhoeffer*, 573 U.S. at 416 (quoting 90 Stat. at 1590).

Congress has further demonstrated its support for ESOPs by enacting numerous tax incentives and other benefits to encourage their adoption. *See Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003) (explaining that "Congress, believing employees' ownership of their employer's stock a worthy goal, has encouraged the creation of ESOPs … by giving [them] tax breaks"); Cong. Research Serv., RS21526, *Employee Stock Ownership Plans (ESOPs) Legislative History* 2 (May 20, 2003), *available at* https://bit.ly/2LU9BZH (describing incentives for ESOPs). For instance, Congress has provided significant tax advantages for employers who offer ESOPs, allowing them to deduct certain contributions to ESOPs and certain dividends paid to fund participants. 26 U.S.C. §404(a)(9), (k). Congress has authorized owners of closely held corporations to defer taxation on capital gains from certain stock sold to an ESOP. *Id.* §1042. In addition, Congress has created incentives for employees to participate in ESOPs, including deferred tax on net unrealized appreciation in employer securities held in ESOPs, *id.* §402(e)(2), and an exception from the penalty for early distributions for employer stock dividends, *id.* §72(t)(2)(A)(vi).

Those considerable incentives have had their intended effect: ESOPs are the most common form of employee stock ownership in the United States, and hold some $1.3 trillion in retirement savings on behalf of more than 14 million Americans. *How an Employee Stock Ownership Plan Works*, Nat'l Ctr. for Emp. Ownership (Apr. 10, 2018), https://bit.ly/2Kh5Bix; *Employee Ownership by the Numbers*, Nat'l Ctr. for Emp. Ownership (July 2019), https://bit.ly/2ywlhsU. Moreover, research has indicated that Congress' faith

in ESOPs has been well-placed. Companies with ESOPs "are more productive and profitable, survive longer, and [have] better shareholder returns." Steven F. Freeman, *Effects of ESOP Adoption and Employee Ownership: Thirty Years of Research and Experience* 10 (Univ. of Penn. Organizational Dynamics Program, Working Paper No. 07-01, 2007), *available at* https://bit.ly/2ZrbHDp; *see also id.* at 11-13, 23; *Enron and Beyond: Enhancing Worker Retirement Security: Hearing Before the H. Subcomm. on Emp'r-Emp. Relations*, 107th Cong. 12, 99-101 (Feb. 13, 2002) (statement of Douglas Kruse, Professor, Rutgers Univ.). Employees benefit from ESOPs, both through compensation gain and through increased workplace participation, commitment, and satisfaction. *See* Freeman, *supra*, at 6-10 ("Research suggests almost entirely positive effects for individuals of ESOP adoption and, more generally, employee ownership."); *see also Enron and Beyond*, *supra*, at 12, 97-98.

Congress has long understood that many companies appoint members of their senior management team to serve as ERISA plan fiduciaries, both generally and with respect to ESOPs. The decision to have the most trusted senior management dedicate time and effort to ensuring that ERISA plans are prudently managed not only reduces plan costs to the benefit of participants but underscores the corporation's commitment to this important component of employee compensation and satisfaction. Rather than express any concern about this practice, Congress has expressly authorized it. *See* 29 U.S.C. §1108(c)(3).

2. Cognizant that Congress "has written into law its interest in encouraging [ESOPs]," *Dudenhoeffer*, 573 U.S. at 416, and that corporate insiders frequently serve as plan fiduciaries, federal courts have long recognized the need to ensure that a drop in the price of a company stock does not automatically entail costly litigation. The ease of alleging that the company stock was overvalued before the price drop and that corporate insiders should have known better could readily threaten the viability of ESOPs. Before this Court's decision in *Dudenhoeffer*, the lower courts uniformly countered that threat by erecting a "presumption of prudence" that strictly limited the circumstances in which an ESOP fiduciary could be held liable for investing plan assets in employer stock. *See* Pet.App.7a. In *Dudenhoeffer*, this Court rejected that presumption as atextual, but also recognized that the weighty concerns that prompted its adoption could be better accommodated through other means. In particular, this Court recognized that meritless and economically burdensome lawsuits would "unduly discourage employers from offering [such] plans in the first place," 573 U.S. at 425 (quoting *Varity Corp.*, 516 U.S. at 497), and acknowledged the corresponding need for a mechanism to "divide the plausible sheep from the meritless goats," *id.* The Court concluded "[t]hat important task can be better accomplished through careful, context-sensitive scrutiny of a complaint's allegations" to determine whether those allegations state a plausible claim. *Id.*

The Court emphasized that in the ERISA context, a motion to dismiss "requires careful judicial consideration of whether the complaint states a claim that the defendant has acted imprudently." *Id.* That

determination "will necessarily be context specific." *Id. Dudenhoeffer* nonetheless outlined certain general rules to guide lower courts. Initially, the Court observed that claims that fiduciaries should have proceeded differently based on publicly available information would necessarily involve claims that plan fiduciaries should have outthought the market and thus would be implausible absent unusual circumstances. *Id.* at 426-27.

As to duty-of-prudence claims based on inside information, the Court made three important observations. First, a fiduciary with adverse inside information need not break the law by trading on that information. *Id.* at 428-29. Second, "where a complaint faults fiduciaries … for failing to disclose [inside] information to the public," courts should consider, *inter alia*, whether mandating disclosure under ERISA could conflict with the objectives of the complex "corporate disclosure requirements" imposed by the securities laws. *Id.* at 429. Third, the Court emphasized that "courts faced with such claims should also consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position *could not have concluded* that [the proposed alternative action] would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund." *Id.* at 429-30 (emphasis added).

3. This Court reinforced the same principles two years later in *Amgen*, another case in which plan participants sued fiduciaries for failing to act on alleged inside information that the employer's stock was overvalued. Once again, the Court recognized

that ESOP fiduciaries "confront unique challenges given 'the potential for conflict' that arises when fiduciaries are alleged to have imprudently 'failed to act on inside information.'" *Amgen*, 136 S. Ct. at 759 (brackets omitted) (quoting *Dudenhoeffer*, 573 U.S. at 423). And once again, the Court explained that, in light of those unique challenges, lower courts must evaluate whether the plaintiff 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.'" *Id.* at 760 (quoting *Dudenhoeffer*, 573 U.S. at 430). Applying that standard, this Court found the complaint's allegations—which relied on generic claims that the plan fiduciaries should have removed an Amgen stock fund as a plan investment option, without any facts plausibly showing that a prudent fiduciary "could not have concluded" that action would do more harm than good—to be inadequate. *Id.*

B. Factual and Procedural Background

1. IBM is a multinational cognitive solutions and cloud platform company that helps clients around the world address their essential needs. Since 1983, IBM has offered its employees the opportunity to invest in the company through an ESOP, which is an investment option in IBM's defined-contribution 401(k) Plus Plan (the "Plan"). Pet.App.26a-27a. During that same time period, IBM, like many other major corporations, has designated senior corporate officials to serve as fiduciaries for the Plan generally and the ESOP in particular. *See* J.A.109-10; *Dudenhoeffer*, 573 U.S. at 423 (noting that "ESOP fiduciaries often are company insiders"). At the time

relevant here, some petitioners served as named fiduciaries of the Plan and as senior corporate officers of IBM, with Martin Schroeter as the chief financial officer and Robert Weber as the general counsel. Pet.App.3a.

2. In 2015, two putative class actions were filed against IBM and some of its officers, one under the federal securities laws and one under ERISA. Both actions asserted, based on materially identical allegations, that IBM had made public misrepresentations that artificially inflated the price of its common stock.

In each case, the allegations focused on IBM's former Microelectronics assets, which designed and produced microchips. Pet.App.3a-4a, 27a. According to the complaints, IBM began making plans to sell those assets in 2013. Pet.App.27a. It hired an investment bank to solicit offers from potential suitors, but had difficulty finding a buyer. Pet.App.27a. In the meantime, IBM continued to operate the Microelectronics assets, making periodic disclosures to the market about their financial condition. Pet.App.27a. According to the complaints, IBM's disclosures in 2014 regarding Microelectronics were materially inaccurate, reporting positive news and figures even though the assets were actually losing hundreds of millions of dollars. Pet.App.3a, 27a.

On October 20, 2014, IBM announced the sale of Microelectronics to GlobalFoundries Inc. Pet.App.3a, 27a. The announcement disclosed that as part of the sale, IBM would pay GlobalFoundries $1.5 billion to take over Microelectronics while GlobalFoundries

would enter a long-term agreement with IBM to supply IBM with semiconductors. IBM had previously assigned a carrying value of $2.4 billion to the assets. Pet.App.3a, 27-28a. The announcement disclosed that IBM would take a $4.7 billion pre-tax charge, reflecting in part the impairment in Microelectronics' stated value. Pet.App.3a.

On the same day, IBM separately issued a press release disclosing disappointing third-quarter operating results and related developments. J.A.77; *see* J.A.129-30. Among other things, those results revealed that sales on continuing operations (which excluded the Microelectronics assets) had declined 4%; operating profits had declined 10%; and gross profit margin had declined 90 basis points. J.A.130. IBM's stock price subsequently declined by 7.11% (over $12 per share). Pet.App.3a-4a, 28a.

3. In the securities class action, the plaintiffs asserted that IBM and certain senior IBM officers had fraudulently concealed Microelectronics' impaired value, and thereby artificially inflated IBM's stock price. *Int'l Ass'n of Heat & Frost Insulators & Asbestos Workers Local #6 Pension Fund v. Int'l Bus. Mach. Corp.* ("*Insulators*"), 205 F. Supp. 3d 527, 530-32 (S.D.N.Y. 2016); *see* Pet.App.4a. The district court dismissed the case, holding that the plaintiffs had failed to plead a viable securities fraud claim. In particular, the district court found, the plaintiffs had failed to allege facts showing either that the need to write down Microelectronics' value was so apparent that the failure to take an earlier write-down amounted to fraud, or that the defendants knew that IBM's earnings-per-share projections lacked a

reasonable basis. *Insulators*, 205 F.3d at 537-38; *see* Pet.App.4a. That decision was not appealed.

Meanwhile, respondents filed this putative ERISA class action on behalf of ESOP participants who purchased IBM stock between January and October 2014, asserting that the same purported fraud alleged in the securities class action made IBM stock an imprudent investment for the IBM ESOP. *See* J.A.78 (noting the "substantially similar factual allegations" in the two complaints); Pet.App.4a. In their first amended complaint, respondents asserted that petitioners violated their duty of prudence by continuing to invest the ESOP's funds in IBM stock notwithstanding their insider knowledge, as IBM executives, that IBM's market price was artificially inflated by the overvaluation of the Microelectronics assets. J.A.79-80; Pet.App.4a. Respondents alleged two purportedly more prudent alternatives: Petitioners should have either disclosed inside information regarding the true value of Microelectronics, or frozen further Plan investments in IBM stock. J.A.80; Pet.App.4a-5a.

The district court dismissed respondents' ERISA complaint on the same day it dismissed the securities action. *See* J.A.77-78. As *Dudenhoeffer* requires, the district court carefully evaluated respondents' complaint, and held that their "rote recitation of proposed remedies" failed to allege any facts plausibly showing that a prudent fiduciary "'could not have concluded' that public disclosures, or halting the Plan from further investing in IBM stock, were more likely to harm than help the fund." J.A.88-90.

As to respondents' disclose or stop-buying alternatives, the district court explained that *Dudenhoeffer* "recognized the possibility that prudent fiduciaries could" conclude that such options "'would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund.'" J.A.87 (quoting *Dudenhoeffer*, 573 U.S. at 430). As such, respondents needed to put forward specific "facts and allegations" explaining why "a prudent fiduciary in the same position *could not have concluded*" that disclosing that negative information "would do more harm than good." J.A.87 (emphasis in original) (quoting *Amgen*, 136 S. Ct. at 760). Respondents' generic allegation that "delay in disclosing an alleged fraud always harms investors in the plan" was insufficient because that allegation was "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." J.A.89.

The district court gave respondents leave to amend, and they filed a second amended complaint adding some detail and a third purported alternative action: that petitioners could have purchased hedging products that would offset any decline in IBM stock. Pet.App.5a, 30a. The district court again dismissed the case, explaining that while the amended complaint "is longer than its previous iteration … much of it is adorned with conclusory allegations" and "bereft of context-specific details." Pet.App.32a. Once again, respondents relied on the generic assertion that "the longer a fraud goes on, the harsher the correction," and "attempt[ed] to buttress that proposition with various academic articles and studies." Pet.App.33a-

34a. Those studies, however, "only underscore[d] the general," non-case-specific nature of respondents' allegations. Pet.App.34a. The district court also faulted the complaint for "fail[ing] to consider how a prudent fiduciary … would have accounted for the potential ill-effects resulting from a premature disclosure." Pet.App.37a. While respondents had alleged that "according to IBM's public filings," the plan "was a net buyer of IBM stock" during the class period, J.A.138, the district court explained that respondents had misread those public filings, which actually showed that the plan purchased $111 million in IBM stock in 2014 and *sold* $391 million in the same period—making the plan a net seller by a substantial margin and meaning that precipitating an earlier stock drop would have *hurt* the plan as a whole, Pet.App.34a-35a. Respondents later conceded that their allegation that the plan was a net buyer was "erroneous[]." C.A.Dkt.36 at 36 n.3.[1]

Along with their mistaken claim that the plan was a net buyer, respondents alleged "in conclusory fashion" that "no prudent fiduciary could have concluded that earlier disclosure would have done more harm than good." Pet.App.38a. But as the district court recognized, "the whole point of *Dudenhoeffer* was to weed out meritless claims based on nothing more than … *ipse dixit* assertions, and to encourage 'careful judicial consideration' of alternative actions predicated on context-specific

[1] Respondents have since removed the allegation that the plan was a net buyer during the class period from their third and fourth amended complaints, filed after the Second Circuit issued its opinion. *See* Dist.Ct.Dkt.74, ¶104; Dist.Ct.Dkt.75, ¶103.

allegations." Pet.App.38a. Because respondents gave "short shrift" to that standard, Pet.App.38a, and failed to allege specific facts plausibly showing that a prudent fiduciary could not have concluded that the proposed alternative actions would do more harm than good to the fund, the district court dismissed the second amended complaint.

C. The Second Circuit's Decision

On appeal, respondents abandoned all but one of the proposed alternative actions, choosing to rely solely on their "corrective disclosure" theory: that a prudent fiduciary would have disclosed earlier that Microelectronics was overvalued. Unlike the district court, the Second Circuit found respondents' generalized allegations sufficient.

1. The Second Circuit began by discussing at length whether *Dudenhoeffer* and *Amgen* require a plaintiff to allege facts showing that a prudent fiduciary "*would* not have" viewed the proposed alternative as more likely to harm the fund than help it, or that a prudent fiduciary "*could* not have" done so. Pet.App.11a; *see* Pet.App.7a-15a. The panel perceived a substantive difference between these two formulations, in that the former asks "whether the *average* prudent fiduciary" would have viewed the proposed alternative as harmful, while the latter asks "whether *any* prudent fiduciary" could have taken that view. Pet.App.11a.

The panel recognized that *Amgen* by its terms applied the "could not have" standard, Pet.App.12a-13a (quoting *Amgen*, 136 S. Ct. at 760), and that the only two circuits to rule on the issue have likewise adopted the "could not have" standard, Pet.App.14a

(citing *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). The panel ultimately avoided deciding the issue, holding that respondents' allegations would suffice under either standard.

2. The Second Circuit determined that "[s]everal allegations in the amended complaint, considered in combination … plausibly establish" that a prudent fiduciary "could not have concluded that corrective disclosure would do more harm than good." Pet.App.15a (citation omitted). The Second Circuit began by citing general allegations that petitioners knew the stock was overvalued, that they could have disclosed the relevant information, and that the stock traded in an efficient market, *see* Pet.App.15a-16a, 18a-19a. The court then relied on respondents' generic allegation that the "eventual disclosure of a prolonged fraud causes reputational damage that increases the longer the fraud goes on." Pet.App.16a. Although recognizing "the possibility of similar allegations in other ERISA cases," the panel held that their general nature "does not undermine their plausibility here (or, for that matter, elsewhere)." Pet.App.17a. Finally, the panel relied on respondents' allegation that because "IBM was likely to sell" the Microelectronics assets, disclosure of the inside information was "inevitable." Pet.App.19a. According to the panel, when a drop in stock price is "inevitable," it "is far more plausible that a prudent fiduciary would prefer to limit the effects [of that drop] through prompt disclosure." Pet.App.19a (quoting *Dudenhoeffer*, 573 U.S. at 430).

Based on these allegations, the panel held that respondents had sufficiently pleaded that "no prudent fiduciary in [petitioners'] position could have concluded that earlier disclosure would do more harm than good." Pet.App.21a. The panel did not address the fact that the plan was a net seller during the class period, *see* Pet.App.35a, such that an earlier drop in the price of the stock would have hurt the fund as a whole. In addition, the panel acknowledged that "allowing [respondents'] ERISA claim to go forward on essentially the same facts" as the failed securities fraud suit could "lead to an end run around the heightened pleading standards for securities fraud suits set out in the" Private Securities Litigation Reform Act ("PSLRA"), 15 U.S.C. §78u-4(b), and deemed that concern "not without merit." Pet.App.22a. Nevertheless, it determined that that danger "d[id] not provide a basis to affirm the district court's dismissal of Jander's duty-of-prudence claim." Pet.App.22a.

SUMMARY OF ARGUMENT

Respondents' second amended complaint fails to state an ERISA duty-of-prudence claim. Respondents' claim fails at the threshold because it is premised on the assertion that petitioners violated their ERISA duty of prudence by failing to use inside information that they learned in their *corporate* capacities when making plan-related decisions in their *fiduciary* capacities. But there is no such duty. ERISA expressly allows employers to appoint their corporate officers as plan fiduciaries, and it does not obligate those corporate officers to potentially breach their duties to the corporation in order to carry out their

fiduciary roles. Instead, as this Court has recognized, the corporate and fiduciary duties are distinct, and when a corporate officer wears her fiduciary hat, there is no obligation to use inside information gathered in her corporate capacity. A contrary rule would frustrate the objectives of the finely-tuned regulatory disclosure regime imposed by the securities laws (which did not require disclosure here, as evidenced by the dismissal of the securities class action) and threaten the viability of the longstanding and congressionally authorized practice of having corporate officers serve as plan fiduciaries.

If, however, ESOP fiduciaries have an obligation to use inside information when making investment decisions for the plan, it becomes that much more important to insist on specific and plausible allegations of a duty-of-prudence breach. This Court has done just that by twice insisting that an ERISA plaintiff plausibly allege facts showing that a prudent fiduciary "could not have concluded" that an alternative action would do more harm than good. *Dudenhoeffer*, 573 U.S. at 430; *Amgen*, 136 S. Ct. at 760. That standard follows directly from the nature of the duty ERISA imposes. The duty of prudence recognizes that in difficult situations like those confronting an insider fiduciary with material nonpublic corporate information, there may be a range of prudent actions available. If there is an obvious alternative that a prudent fiduciary *could not have* rejected, then liability is appropriate. But absent plausible allegations of that nature, the fiduciary has not violated a duty of prudence and should not incur personal liability.

Applying that "could not have concluded" standard here, respondents' generalized allegations fall far short of what *Dudenhoeffer* requires. Respondents offer only generic allegations that no fraud lasts forever, that the harm of an undisclosed fraud only grows over time, and that disclosure sooner rather than later is always the prudent course. Those allegations could be leveled in any case (indeed, were leveled unsuccessfully by the same lawyer in the Fifth and Sixth Circuits), and do nothing to suggest that this case presented unusual circumstances that made an early and extraordinary disclosure unlikely to do more harm than good to the fund.

If the generic sooner-rather-than-later allegations here are deemed sufficient, multiple congressional policies would suffer. If such easy-to-allege and costly-to-disprove suits proliferate, many companies will abandon ESOPs altogether, despite a clear congressional preference for them. At a minimum, many companies will abandon the longstanding and congressionally authorized practice of having corporate officers serve as plan fiduciaries, with an attendant increase in costs. Finally, Congress' elaborate efforts to weed out meritless securities suits will be frustrated, as lawsuits involving the same alleged frauds and same inside information fail as securities claims but move forward as ERISA claims. This Court need look no further than this case to confirm that is the inevitable result of the Second Circuit's misguided standard. In the end, the clear path to honoring Congress' judgments and this Court's precedents is to dismiss the duty-of-prudence claim here for failure to state a claim.

ARGUMENT

I. Respondents' Suit Fails To State A Claim Because ESOP Fiduciaries Generally Have No Obligation To Use Inside Information Obtained In A Corporate Capacity When Making Fiduciary Decisions.

Respondents' duty-of-prudence claim is premised on the theory that petitioners acted imprudently by failing to use nonpublic corporate information, which they learned in their role as company officers, to make investment-related decisions in their separate role as ESOP fiduciaries. That claim fails at the threshold because it is premised on a duty that does not exist. Congress has expressly authorized corporate officers to serve as plan fiduciaries, and this Court has recognized that the roles of corporate officer and plan fiduciary are distinct. There is simply no general duty for plan fiduciaries to use material nonpublic information learned in a *corporate* capacity to make decisions in their *fiduciary* capacity. Conflating the two roles creates all manner of problems as material nonpublic information—both positive and negative—is ubiquitous inside the C-suite, and Congress has provided a finely reticulated regime governing the nature and timing of disclosures of corporate information by corporate officers. Superimposing a series of judge-made requirements for the disclosure of corporate information by corporate insiders who serve as plan fiduciaries would frustrate both the objectives of the securities regime and Congress' judgment that corporate officers can serve as plan fiduciaries.

A. Congress Authorized Corporate Officers to Serve as ESOP Fiduciaries Even Though the Two Roles Involve Different and Frequently Conflicting Duties to Different Stakeholders.

In a conscious departure from the common law of trusts, Congress expressly authorized company officers to serve as plan fiduciaries. Under the common law of trusts, fiduciaries are generally prohibited from holding positions that could create a conflict of interest with trust beneficiaries. *See Pegram v. Herdrich*, 530 U.S. 211, 225 (2000); *Varity Corp.*, 516 U.S. at 498; George G. Bogert & George T. Bogert, *Law of Trusts and Trustees* §543, at 218, 264 (rev. 2d ed. 1992). ERISA, however, departs from that common-law rule, expressly allowing the same individual to "serv[e] as a fiduciary in addition to being an officer, employee, agent, or other representative of [the employer]." 29 U.S.C. §1108(c)(3); *see Pegram*, 530 U.S. at 225 (recognizing that "[e]mployers … can be ERISA fiduciaries"). That approach recognizes the advantages to both employers and employees of allowing companies to manage their ERISA plans internally, reducing costs and taking advantage of their own officers' expertise and judgment.

At the same time, the fact that the same person may be both a corporate officer and a plan fiduciary does not mean that the two roles become merged. As this Court explained in *Pegram*, "the trustee under ERISA may wear different hats," one as a corporate officer and one as a plan fiduciary. 530 U.S. at 225. "ERISA does require, however, that the fiduciary with

two hats wear only one at a time, and wear the fiduciary hat when making fiduciary decisions." *Id.* As such, "[i]n every case charging breach of ERISA fiduciary duty," the "threshold question" is "whether [the defendant] was acting as a fiduciary (that is, was performing a fiduciary function) when taking the action subject to complaint." *Id.* at 226. If the defendant was acting in her fiduciary capacity, her duty runs to plan participants under ERISA; if she was acting in her corporate capacity, her duty runs to the corporation, and is outside the scope of ERISA altogether.

Pegram illustrates that principle. In that case, the plaintiff asserted that the treatment decisions made by her health management organization ("HMO"), acting through its physician employees, violated ERISA because the physician employees would profit from any decision to minimize care and so their treatment decisions were not made solely in the interest of plan beneficiaries. *Id.* at 214, 226. This Court rejected that argument, holding that the treatment decisions at issue "are not fiduciary decisions under ERISA" and so were not governed by ERISA. *Id.* at 237. Because the HMO was not acting in a fiduciary capacity when its physicians decided how to diagnose and cure their patients, it could not be sued under ERISA for those decisions. That conclusion was buttressed by the Court's recognition that a contrary ruling would mean the demise of for-profit HMOs, despite Congress' decision not just to permit but to promote HMOs. *Id.* at 232-34.

Similar principles make clear that a corporate officer serving as a plan fiduciary does not act

imprudently by not making plan decisions based on inside information gathered in her capacity as a corporate officer. To be sure, when a plan fiduciary administers the ESOP, she is plainly wearing her plan-fiduciary hat. But the relevant question is whether, when she acts in that capacity, she has a duty to use material nonpublic information about the company learned while wearing her corporate hat to benefit ESOP participants. The answer is plainly no. Any other answer would create serious problems and undermine Congress' express decision to allow corporate officers to serve as plan fiduciaries. As in *Pegram*, there is no basis for concluding that Congress intended indirectly to prohibit a practice that it expressly authorized.

When corporate officers learn nonpublic information about the company in the course of their corporate duties, they owe a duty to the corporation and *all* its shareholders to use that information in their interests—not in the interests of a *subset* of shareholders (*e.g.*, ESOP participants) or third parties. *See, e.g.*, *United States v. O'Hagan*, 521 U.S. 642, 652 (1997) (recognizing the "relationship of trust and confidence … between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation" (quoting *Chiarella v. United States*, 445 U.S. 222, 228 (1980))). Corporate officers with a "relationship affording access to inside information intended to be available only for a corporate purpose," *Dirks v. SEC*, 463 U.S. 646, 653 (1983) (quoting *Chiarella*, 445 U.S. at 227), would thus risk breaching their duties to the employer if they instead used that information in their fiduciary

capacities to benefit plan participants—especially where (as here) the interests of the plan participants and the broader universe of shareholders are not coterminous.

If ERISA truly required insider fiduciaries to use nonpublic information learned in their corporate capacity when acting in their fiduciary capacity, it would make it practically impossible for corporate insiders to serve as plan fiduciaries. The competing duties would frequently put them between a rock and a hard place: breach a duty to the corporation by using the inside information for plan participants, or breach a duty to the plan participants by failing to use it. The dilemma would be nearly constant, because material nonpublic information—both positive and negative—is ubiquitous in the C-suite. Corporate officers routinely have new information about new products, sales projections, and potential mergers that the market would love to know. The securities laws provide an elaborate framework for when and how such information needs to be disclosed, but those rules still permit corporate officers to be privy to material nonpublic information on a daily basis. *See Chiarella*, 445 U.S. at 233 (rejecting any "general duty between all participants in market transactions to forgo actions based on material, nonpublic information").

The statute cannot be sensibly understood as creating such a common and constant dilemma, especially where Congress expressly permitted the dual roles. On the contrary, as this Court held in *Pegram*, ERISA requires only that "the fiduciary with two hats wear only one at a time, and wear the fiduciary hat when making fiduciary decisions." 530

U.S. at 225. It does not require her to use nonpublic information that belongs under her corporate hat to make plan-related decisions as a fiduciary. *See, e.g.*, *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1282 (11th Cir. 2012) (plan participants "have no right to insist that fiduciaries who are corporate insiders use inside information to the advantage of the participants"); *In re Citigroup ERISA Litig.*, 662 F.3d 128, 133, 142-43 (2d Cir. 2011) (declining to recognize "a duty to provide participants with nonpublic information pertaining to specific investment options"). A contrary rule would make the common and congressionally authorized practice of corporate officers serving as plan fiduciaries infeasible.

B. Obliging ESOP Fiduciaries to Use Inside Corporate Information Increases Conflicts Between ERISA and the Securities Laws.

Requiring ESOP fiduciaries to use inside information acquired in their corporate capacities when making plan-related fiduciary decisions would exacerbate the potential tension between ERISA and the securities laws that this Court recognized in *Dudenhoeffer* and *Amgen*. Insider fiduciaries "confront unique challenges given 'the potential for conflict' that arises when fiduciaries are alleged to have imprudently 'failed to act on inside information they had about the value of the employer's stock.'" *Amgen*, 136 S. Ct. at 759 (brackets omitted) (quoting *Dudenhoeffer*, 573 U.S. at 423). ERISA suits that charge ESOP fiduciaries with failing to use inside information to benefit the plan could easily "conflict with the complex insider trading and corporate

disclosure requirements imposed by the federal securities laws or with the objectives of those laws," threatening once again to subject ESOP fiduciaries to mutually inconsistent legal duties. *Dudenhoeffer*, 573 U.S. at 429. The best way to minimize those conflicts is to recognize that a plan fiduciary does not violate any duty of prudence by failing to use in a fiduciary capacity inside information gained in a corporate capacity.

As *Dudenhoeffer* makes clear, ERISA cannot be read to require an ESOP fiduciary to "perform an action … that would violate the securities laws," such as actively trading on inside information. *Id.* at 428. But even where plaintiffs have alleged an alternative action that does not directly violate the securities laws, such as disclosing inside information to the market or refraining from future purchases, the tension between the securities laws and an ERISA suit premised on the failure to act on corporate inside information remains palpable. *See id.* at 429. The federal securities laws already impose a carefully calibrated regime of disclosure obligations and trading restrictions that govern the use of inside corporate information. Those laws govern corporate officers in the corporate capacity in which they gain inside information and do not uniformly demand immediate disclosure of all material inside information. ERISA cannot plausibly be read to impose new and more demanding disclosure and trading rules for corporate officers, with respect to information acquired in a corporate capacity, above and beyond the requirements of the securities laws. *See Black & Decker Disability Plan v. Nord*, 538 U.S. 822, 831 (2003) ("Although Congress expected courts would

develop a federal common law of rights and obligations under ERISA-regulated plans, the scope of permissible judicial innovation is narrower in areas where other federal actors are engaged." (brackets and citation omitted))

The potential for conflict is particularly stark in cases like this one, where a plaintiff alleges that the insider fiduciaries should have disclosed negative information about the company earlier. As noted, the federal securities laws provide detailed and well-developed rules about disclosure, but they do not demand immediate disclosure of all material nonpublic information. *See, e.g.*, 15 U.S.C. §78m (requiring issuers to comply with SEC disclosure rules); 17 C.F.R. §§240.13a-1, 249.310 (requiring annual reports on Form 10-K); *id.* §§240.13a-13, 249.308a (requiring quarterly reports on Form 10-Q); *id.* §§240.13a-11, 249.308 (requiring current reports on Form 8-K within four business days of certain specified events). Thus, any suggestion that insider fiduciaries must disclose inside information obtained in a corporate capacity even earlier based on judge-made ERISA rules creates the precise conflicts this Court warned against in *Dudenhoeffer* and *Amgen*.[2]

[2] On the contrary, where ERISA does impose disclosure obligations, it does so in clear and express terms. *See, e.g.*, 29 U.S.C. §§1022, 1023, 1024; *Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 83 (1995) (recognizing ERISA's "comprehensive set of reporting and disclosure requirements"). Those statutorily defined obligations do not include any requirement to disclose nonpublic information that a plan fiduciary has learned in his corporate capacity.

The tension between the requirements of the securities laws and ERISA created by the decision below were palpable because the Second Circuit allowed an ERISA suit to proceed where a securities suit based on essentially the same allegations was dismissed. The Second Circuit nonetheless attempted to reconcile the laws by asserting that respondents here had plausibly alleged that the negative information at issue could have been disclosed *through* the SEC reporting regime—specifically, that "disclosures could have been included within IBM's quarterly SEC filings and disclosed to the ESOP's beneficiaries at the same time." Pet.App.16a.

That position fails on multiple levels. First, it only underscores that respondents' suit conflicts with *Pegram*. As numerous courts have recognized, disclosures in SEC filings are made in a corporate capacity, rather than a fiduciary capacity, and so cannot provide the basis for an ERISA claim. *See, e.g.*, *Lanfear*, 679 F.3d at 1284; *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 257 (5th Cir. 2008). Second, it ignores that private efforts to enforce securities-law disclosure obligations are accompanied by the restrictions of the PSLRA—restrictions that proved fatal to the securities action here. Finally, the assertion that the ESOP fiduciaries here could have disclosed the alleged fraud in a quarterly SEC report does nothing to address the broader inconsistency in respondents' position. The ability to make a later disclosure in an upcoming SEC report does not alter the reality that respondents' theory would demand an earlier disclosure from a plan fiduciary even though the information was learned in a corporate capacity

and even though earlier disclosure could be contrary to the broader interests of the shareholders.[3]

C. Requiring ESOP Fiduciaries to Use Inside Corporate Information Creates Other Anomalies.

The difficulties with imposing fiduciary duties on inside information gained in a corporate capacity are by no means limited to negative information about the company stock or ESOPs. Material nonpublic information is ubiquitous among corporate officers, and much of it is positive. Corporate officers routinely learn of projected sales growth or a possible acquisition before the market has the information or the securities laws require disclosure. But if insider fiduciaries must act prudently for plan participants based on information learned in a corporate capacity, how could they prudently sell undervalued corporate shares without disclosing the information to the market? There is certainly no basis for having one rule for positive nonpublic information and a different rule for negative nonpublic information. But if the only options open to insider fiduciaries are to stop trading or prematurely disclose in good times and bad,

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[3] Even if a complaint tried to minimize the conflict by alleging a duty-of-loyalty breach solely because the insider fiduciary allegedly failed to make a disclosure required by the securities laws, it would not eliminate the tension. Such a rule would still impose heightened ERISA duties on dual-capacity fiduciaries, and imposing ERISA liability for failure to discharge a securities duty would not only mix apples and oranges but allow the circumvention of limitations on securities suits deliberately fashioned by Congress. *See* pp.58-60, *infra*.

then it will be practically impossible to have corporate insiders serve as ESOP fiduciaries.

The problem is not even limited to the ESOP context. If a corporate officer acts as an ERISA fiduciary for any company-sponsored plan, that officer could potentially learn nonpublic information in his corporate capacity regarding the value of another company in which the plan is invested either directly or as a major holding of a plan fund. For example, suppose that the company is contemplating a merger and learns in the due diligence process inside information that the other company is substantially undervalued. Does the corporate officer really have a duty to don her fiduciary hat and prevent plan participants from selling an undervalued holding even though doing so will harm the corporation by causing the cost of acquiring the target to rise substantially? The answer to that question is plainly no. When Congress authorized corporate officers to serve as ERISA fiduciaries, it was not creating a liability trap or placing those corporate officers between a rock and hard place. Instead, Congress understood that in discharging the two functions, the individuals would wear different hats, with differently loyalties and different information streams. *See* 29 U.S.C. §1108(c)(3); *Pegram*, 530 U.S. at 225; *Varity Corp.*, 516 U.S. at 498. In sum, the duty of prudence imposed by ERISA does not require insider fiduciaries to use nonpublic information learned in their corporate capacities when acting in their fiduciary capacities. *See Pegram*, 530 U.S. at 225-26; *Lanfear*, 679 F.3d at 1282. Because respondents' suit is premised on a duty that does not exist, it should be dismissed.

II. Respondents' Suit Fails Because A Prudent Fiduciary Could Have Concluded That Disclosure Of The Inside Information Here Would Do More Harm Than Good To The Fund.

If, contrary to the argument above, an insider fiduciary really does have an obligation to use inside corporate information in making investment decisions for the plan, then it is especially important to reaffirm that duty-of-prudence claims based on the failure to act on such inside information can proceed only where a plaintiff plausibly alleges that a prudent fiduciary could not have concluded that disclosure of the inside information would do more harm than good to the fund. Insider fiduciaries face a host of competing interests and uncertainties. They must account for the interests of long-term participants with substantial holdings of company stock, and new participants just beginning to build a position. They also must make difficult predictions about how the market would react to disclosures. Thus, absent allegations that a prudent fiduciary could not have pursued the course taken, an ESOP fiduciary should not face personal liability based on the hindsight that inevitably accompanies a stock drop. The generalized allegations here do not come close to satisfying that standard.

A. Plaintiffs Must Plausibly Allege That a Prudent Fiduciary in the Defendants' Position Could Not Have Concluded That an Alternative Action Would Do More Harm Than Good to the Fund.

In *Dudenhoeffer*, this Court explained that to state an ERISA duty-of-prudence claim, a plaintiff must plausibly allege facts showing "that the defendant has acted imprudently." 573 U.S. at 425. In particular, in enumerating the three special considerations applicable when a plaintiff asserts that an ESOP fiduciary has acted imprudently by failing to act on inside information, this Court specified that the plaintiff must allege a concrete alternative action that the defendant could have taken, and plausibly show that "a prudent fiduciary in the defendant's position *could not have concluded* that [this alternative] would do more harm than good to the fund." *Id.* at 429-30 (emphasis added). Nonetheless, the Second Circuit opined that it was "not clear" whether the plaintiff's burden was to allege merely that a prudent fiduciary would have taken a different course or that a prudent fiduciary could not have concluded that the alternative would be more harmful on balance. Pet.App.11a. The difference is material, and ERISA's text and structure, this Court's precedents, and sound policy all make clear that the more demanding "could not have concluded" standard governs duty-of-prudence claims.

1. The "could not have" standard follows from the statutory text and structure.

The "could not have" standard follows directly from the underlying substantive requirements of an ERISA duty-of-prudence claim and the reality that a prudence standard allows for a variety of reasonably prudent approaches, including some that look suboptimal in hindsight. ERISA authorizes a plaintiff to seek redress from a plan fiduciary when a fiduciary has "breache[d] any of the responsibilities, obligations, or duties imposed upon fiduciaries by [ERISA]." 29 U.S.C. §1109(a). When such a breach is proven, the fiduciary is individually liable. *Id.* The statute identifies the duty of prudence as the duty to act with the same prudence "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." *Id.* §1104(a)(1)(B). The statutory duty thus accounts for both hindsight bias ("under the circumstances then prevailing") and the particular capacity in which the fiduciary acts. *Id.*

Critically, the prudence standard does not generally dictate a single required course of action. While requiring some degree of investigation of investments and evaluation of risks, it does not dictate the precise form of those endeavors. Instead, the prudence standard implicitly recognizes that a prudent fiduciary may "have a range of options … depending upon the circumstances," and that two fiduciaries in the same position could reasonably choose different courses without either acting

imprudently. *Diduck v. Kaszycki & Sons Contractors, Inc.*, 874 F.2d 912, 917 (2d Cir. 1989); *accord*, *e.g.*, *Sweda v. Univ. of Pa.*, 923 F.3d 320, 333 (3d Cir. 2019) (ERISA permits "varied approaches to the prudent investment of assets" (brackets omitted)); *Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006) (prudent fiduciaries have no "duty to take any particular course of action if another seems preferable"). As long as a fiduciary chooses a course that is within the range of prudent options available, she has satisfied her duty under ERISA to use "care, skill, prudence, and diligence" in fiduciary decisions, even if another fiduciary might have chosen a different but still prudent course. 29 U.S.C. §1104(a)(1)(B); *see* Restatement (Third) of Trusts §90 cmt. h (2007) (recognizing "endless variations in reasonable strategies for investing and for the prudent management of risk").

By recognizing a spectrum of possible prudent decisions, ERISA's duty of prudence marks a decision as imprudent only if it is an outlier, lying beyond the range of possible prudent choices—that is, a course *no* prudent fiduciary could have taken. The proper pleading standard follows directly from that underlying substantive rule. In order to plausibly allege that a fiduciary has failed to exercise the "prudence" that ERISA requires, 29 U.S.C. §1104(a)(1)(B), the question is not, as the Second Circuit put it, "whether the *average* prudent fiduciary *would have* thought [an] alternative action would do more harm than good," but rather "whether *any* prudent fiduciary *could have*" reached that conclusion. Pet.App.11a (second and fourth emphasis added). If a reasonable fiduciary could have declined to take the

alternative action proposed by the plaintiff, then the actual fiduciary's failure to pursue that course is not imprudent.

The problem with a "would have" standard is that nothing in ERISA requires every plan fiduciary to do what a hypothetical *average* prudent fiduciary *would have* done in the same circumstances. Indeed, ERISA gives courts little guidance in concocting a hypothetical average prudent fiduciary, and it expressly precludes courts from engaging in hindsight to determine what the average fiduciary in fact did in comparable circumstances. But while giving the courts and fiduciaries no real guidance, that standard would make the average choice an essentially mandatory course of action, and punish fiduciaries with substantial personal liability for straying from the average choice among a range of prudent options. In reality, the statute demands neither extreme foresight nor mediocrity, but only requires plan fiduciaries to exercise the "care, skill, prudence, and diligence" of a prudent person, by choosing one of the various prudent actions that a prudent fiduciary *could have* chosen. Unless a plaintiff plausibly alleges (and eventually proves) facts showing that no prudent fiduciary could have taken the course the defendant chose—because a prudent fiduciary "could not have concluded that [an alternative action] would do more harm than good to the fund"—he has not alleged facts showing that the defendant failed to exercise the care and prudence that ERISA requires. *Dudenhoeffer*, 573 U.S. at 430; *Amgen*, 136 S. Ct. at 760.

2. The "could not have" standard follows from this Court's precedent.

The "could not have" standard follows not only from the statutory text and structure, but from this Court's precedent as well. In both *Dudenhoeffer* and *Amgen*, this Court unanimously relied on that standard in vacating or reversing the decisions below. *See Dudenhoeffer*, 573 U.S. at 429-30 (instructing lower courts to "consider whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position *could not have concluded* that [an alternative action] would do more harm than good" (emphasis added)); *Amgen*, 136 S. Ct. at 760 (reversing the Ninth Circuit for "fail[ing] to assess whether the complaint … 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" (emphasis added)). The lower courts that have squarely addressed the question have properly followed that example. *See, e.g.*, *Whitley v. BP, P.L.C.*, 838 F.3d 523, 529 (5th Cir. 2016) (plaintiff must show "a prudent fiduciary *could not conclude* that [an alternative action] would be more likely to harm the fund than help it"); *Saumer v. Cliffs Nat. Res. Inc.*, 853 F.3d 855, 864 (6th Cir. 2017) (same).

a. The panel below nonetheless purported to find *Dudenhoeffer* and *Amgen* "not clear" as to whether to apply a could-not-have standard or an average-prudent-fiduciary test Pet.App.11a. The panel's uncertainty is surprising, given that neither *Dudenhoeffer* nor *Amgen* ever suggested measuring the plaintiffs' proposed alternatives against what an average prudent fiduciary would have done. Indeed,

the term "average prudent fiduciary" appears nowhere in either decision. Nor has any other court read *Dudenhoeffer* and *Amgen* to adopt a standard that asks what an average prudent fiduciary would have done.[4]

The panel's confusion stemmed from an earlier passage in *Dudenhoeffer*, quoted in *Amgen*, in which this Court explained that a plaintiff must allege an alternative action "that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." *Dudenhoeffer*, 573 U.S. at 428; *Amgen*, 136 S. Ct. at 759. In the panel's view, that passage "suggests that courts ask what an average prudent fiduciary might have thought." Pet.App.11a.

The panel overread that passage, which does not mention a hypothetical average prudent fiduciary. Instead, that passage is best understood as reflecting the basic requirement that the plaintiff's allegations foreclose the possibility that a prudent fiduciary would do the same thing that the defendant in fact did. Unless the plaintiff's allegations foreclose that possibility, there is no violation of the duty of prudence. Certainly, identifying a single prudent fiduciary who would have pursued the proposed alternative is insufficient, and as discussed, converting the average response to a range of prudent options into the sole standard of prudence would be contrary to the statute. In all events, any possible ambiguity in that passage is removed three

[4] In fact, it appears that the decision below stands alone as the only ERISA duty-of-prudence decision ever to use the phrase "average prudent fiduciary."

paragraphs later when the Court elaborates on the third of the considerations that "inform the requisite analysis." *Dudenhoeffer*, 573 U.S. at 428; *see id.* at 429-30. There, the Court specifies that lower courts should look to whether the plaintiff has alleged proposed alternatives that a prudent fiduciary "*could not have* concluded … would do more harm than good." *Id.* at 430 (emphasis added); *Amgen*, 136 S. Ct. at 759-60. And that is the standard upon which *Dudenhoeffer* relied and that *Amgen* actually applied to the complaint at issue in that case.

b. The "could not have" standard is likewise the only one that accords with the basic principles that underlie *Dudenhoeffer*. As *Dudenhoeffer* explained, in the ERISA context, a motion to dismiss is an "important mechanism for weeding out meritless claims" that "requires careful judicial consideration of whether the complaint states a claim that the defendant has acted imprudently." 573 U.S. at 425. That mechanism is especially important in the context of ERISA claims against insider fiduciaries, since any time a corporate insider serves as a fiduciary and there is a stock drop associated with a disclosure, it will be possible to allege that the drop was inevitable and that insiders should have disclosed earlier. Allowing such claims to proceed into discovery will impose heavy administrative and legal costs on those ESOPs and their fiduciaries. *See Pension Benefit Guar. Corp. v. Morgan Stanley Inv. Mgmt., Inc.*, 712 F.3d 705, 719 (2d Cir. 2013) (recognizing that "the prospect of discovery in a suit claiming breach of fiduciary duty is ominous, potentially exposing the ERISA fiduciary to probing and costly inquiries and document requests"). Those costs will undermine

Congress' decision to authorize insiders to serve as plan fiduciaries and its clear intent to promote and encourage ESOP participation. It is therefore critically important that the standard for pleading an ERISA claim against ESOP fiduciaries "readily divide the plausible sheep from the meritless goats," *Dudenhoeffer*, 573 U.S. at 425, separating the rare cases of genuine imprudence from the mine-run of ERISA class actions filed whenever a company's stock drops.

A standard that requires the plaintiff to allege (and eventually show) that a prudent fiduciary *could not have* concluded that the proposed alternative would be harmful to the fund fits precisely with that purpose (and ERISA's substantive requirements), requiring the plaintiff to plausibly allege that defendant's actions were outside the range of possible prudent alternatives. By contrast, a standard that asks whether the *average* prudent fiduciary (or worse yet, just one prudent fiduciary) *would* have pursued the plaintiff's suggested alternative course of early disclosure is not only inconsistent with the statute, but also plainly fails to "readily divide the plausible sheep from the meritless goats," *id.*, since plaintiffs will almost always be able to plausibly allege that some prudent fiduciary or a hypothetical *average* prudent fiduciary would have made a different choice from a range of prudent options.

Allowing plaintiffs to obtain discovery by alleging that the average prudent fiduciary would have acted differently thus threatens to subject ESOP fiduciaries to constant retrospective second-guessing of their decisions. Even where it is clear that the fiduciary has

made *a* prudent decision (and so discharged her duties under ERISA), a standard based on what the *average* prudent fiduciary *would* have done could still open the door for plaintiffs to seek burdensome discovery and an *in terrorem* settlement. *Cf. AT&T Mobility v. Concepcion*, 563 U.S. 333, 350 (2011) (recognizing "the risk of 'in terrorem' settlements that class actions entail"). The concerns raised in *Dudenhoeffer* thus cannot be addressed by a standard that requires only allegations that some other prudent fiduciary or the hypothetical average prudent fiduciary would have chosen a different course.

3. The "could not have" standard appropriately protects ESOP fiduciaries forced to balance competing interests.

The "could not have" standard appropriately recognizes that ESOP fiduciaries must balance potentially conflicting interests (and do so with imperfect information), and that, therefore, reasonable prudent fiduciaries could strike that balance differently. Under ERISA, ESOP fiduciaries are required to act in the best interests of "the participants and beneficiaries" of the plan as a whole, not just the subset of plan participants who made new purchases of company stock at prices that might appear inflated in light of a subsequent stock drop. 29 U.S.C. §1104(a)(1); *see, e.g.*, *Varity Corp.*, 516 U.S. at 514 (trustee must "take impartial account of the interests of all beneficiaries"). For that reason, as *Dudenhoeffer* recognized, ESOP fiduciaries must focus on whether an alternative action "would do more harm than good *to the fund*" as a whole, rather than to

individual participants. 573 U.S. at 430 (emphasis added); *see Amgen*, 136 S. Ct. at 759.

The participants in any given ESOP do not have uniform interests. Among other things, ESOP participants may include individuals who are building a position in the company stock (such as new employees just joining the plan), individuals who are holding substantial shares in the company stock without buying or selling shares, and individuals who are sellers (such as retirees who are drawing down their investments to generate cash during retirement). On a daily basis, therefore, ESOP fiduciaries must balance numerous and often competing interests in making fiduciary decisions. For example, fiduciaries must weigh the preferences of new plan participants, who benefit when the company stock price dips, against existing holders and retiring sellers, who benefit when the stock price rises. And insider fiduciaries must balance all these competing interests in the face of substantial uncertainties about whether and when potential deals will be consummated and how the market would react to the disclosure of nonpublic information.

A standard imposing liability only where a prudent fiduciary *could not have* rejected a proposed alternative provides the necessary play in the joints for a fiduciary facing competing demands and imperfect information. For example, as numerous courts have recognized, prudent fiduciaries could readily (and reasonably) disagree on whether to disclose negative information about the company when immediate disclosure might help new plan participants buying company stock, but would also

cause a dramatic "drop in the value of the stock already held by the fund" and so harm plan participants who are either holders or net sellers. *Dudenhoeffer*, 573 U.S. at 430; *see, e.g.*, *Martone v. Robb*, 902 F.3d 519, 526-27 (5th Cir. 2018); *Saumer*, 853 F.3d at 864; *Whitley*, 838 F.3d at 529. The play in the joints is particularly important because it will often be difficult to predict how the market will react to the disclosure at some future time, while the immediate negative effects from an immediate and extraordinary disclosure will be much easier to assess. A fiduciary should not be faulted for avoiding an immediate negative event for all the ESOP's current holders in circumstances where the impact of non-disclosure on current purchasers is difficult to predict. The simple assurance that sooner-is-always-better when it comes to disclosure does not begin to capture the complex calculus facing the typical ESOP fiduciary. The "could not have" standard, by contrast, properly limits liability to cases where every fiduciary would make the same call—for instance, choosing to disclose negative information when a new ESOP plan has no existing holdings, and so disclosure can only help plan participants (all of whom are by definition net buyers).

In short, the "could not have" standard not only follows directly from the statute and this Court's precedent, but appropriately safeguards ESOP fiduciaries who must daily balance competing interests in the face of imperfect information in making their difficult fiduciary decisions.

B. Respondents' Generalized Allegations Fail to Plausibly Allege a Breach of the Duty of Prudence.

Judged by the proper "could not have" standard, this should not have been a close case. That standard is demanding, and this Court has gone out of its way to underscore that the plaintiff's allegations must be context-specific and concrete about the available alternative course that made the defendants' failure to disclose imprudent. Generalized allegations that disclosure is inevitable and thus disclosure sooner-rather-than-later is always prudent simply will not suffice. That is particularly true where, as here, the Plan was a net seller of company stock during the relevant period. In those circumstances, immediate disclosure promised immediate harm to the majority of ESOP participants, making the *Dudenhoeffer* standard impossible to satisfy. While the Second Circuit focused on the allegations suggesting that the pending sale of IBM's Microelectronics assets made disclosure inevitable, not even the sale was inevitable, and gauging the market's reaction to a sale that locked in a long-term supply agreement (and other simultaneously disclosed information) was inherently difficult. The notion that the failure to make an earlier extraordinary disclosure was outside the range of prudent courses strains credulity. The proper course here is the one followed by the Fifth and Sixth Circuits reviewing the same basic allegations by the same lawyer—namely, dismissal for failure to state a claim.

1. ***Dudenhoeffer* requires context-specific factual allegations, not generalized and conclusory assertions.**

Dudenhoeffer recognized the threat posed by "meritless, economically burdensome lawsuits" that could "deter companies from offering ESOPs to their employees, contrary to the stated intent of Congress." 573 U.S. at 423-25; *see also Varity Corp.*, 516 U.S. at 497 (recognizing the risk that "administrative costs, or litigation expenses, [could] unduly discourage employers from offering welfare benefit plans in the first place"). As Congress has made clear time and again, its consistent policy has been "encouraging [ESOPs] as a bold and innovative method of strengthening the free private enterprise system" by promoting corporate growth and employee ownership. 90 Stat. at 1590; *see Dudenhoeffer*, 573 U.S. at 424 ("We agree that Congress sought to encourage the creation of ESOPs."); pp.5-7, *supra*. The threats to ESOPs from a lax pleading standard are obvious. Insider fiduciaries have ready access to inside information, and a drop in the price of the company stock after disclosure will make it easy to suggest that earlier disclosure of inside information would have saved new purchasers of company stock from avoidable losses. If such easy-to-level and costly-to-disprove allegations sufficed, the safest course would be for companies to avoid offering ESOPs, which is hardly what Congress intended.

In light of these concerns, this Court in *Dudenhoeffer* recognized the importance of context-specific allegations and concrete suggestions about

what a prudent fiduciary could do to avoid harm to the fund as a whole. This Court acknowledged the concerns that led lower courts to adopt an atextual presumption of prudence, but concluded that the superior mechanism for addressing those concerns was "careful, context-sensitive scrutiny of a complaint's allegations" to determine whether the plaintiff has plausibly asserted facts showing that the fiduciary defendant "has acted imprudently." *Dudenhoeffer*, 573 U.S. at 425. The Court recognized that it would always be easy to allege "imprudence" in the air and that plan fiduciaries with competing obligations to long-term holders and new purchasers were often between a rock and a hard place. Accordingly, the Court demanded specific factual allegations that raise a plausible inference of imprudence by suggesting a clear alternative path that a prudent fiduciary could not have ignored. That inquiry "will necessarily be context specific," turning on the exact circumstances prevailing in each case. *Id.*; *see also Amgen*, 136 S. Ct. at 760 (requiring careful scrutiny of the precise "facts and allegations … in the [plaintiffs'] complaint").

Under these principles, the kind of generalized allegations that could be made in any case (*e.g.*, the truth will win out in the end; disclosure sooner-rather-than-later is always superior) are necessarily insufficient to state a duty-of-prudence claim. Indeed, allowing generalized allegations to suffice would make it impossible for a motion to dismiss to perform the "important task" of "weeding out meritless claims," *Dudenhoeffer*, 573 U.S. at 425. As the Fifth and Sixth Circuits correctly recognized, courts cannot "readily divide the plausible sheep from the meritless goats,"

id., if boilerplate allegations are enough to convert an obvious goat into an apparent sheep.

2. The generalized assertions here are insufficient to plead a plausible duty-of-prudence claim.

Applying these principles here, the Second Circuit plainly erred in reversing the district court's dismissal of the complaint. The Second Circuit relied on concededly generic allegations that no fraud lasts forever and so sooner-rather-than-later disclosure is always prudent, while downplaying case-specific facts, like IBM's status as a net seller, that underscore why a prudent fiduciary could have followed the same course as petitioners. The Second Circuit's analysis is plainly wrong, which explains why it stands alone among lower courts, even as to materially identical allegations by the same lawyer.

a. The central allegation on which the Second Circuit relied was respondents' allegation that an earlier disclosure of negative information is always preferable, because "the eventual disclosure of a prolonged fraud causes 'reputational damage' that 'increases the longer the fraud goes on.'" Pet.App.16a (brackets omitted). By its very terms, that sooner-rather-than-later allegation is applicable in every duty-of-prudence case asserting that an ESOP fiduciary should have disclosed negative information earlier. *See* J.A.89 (district court noting that "[p]laintiffs' argument that delay in disclosing an alleged fraud always harms investors in the Plan is 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."). Indeed, the Second Circuit acknowledged as much. *See* Pet.App.17a.

The Fifth and Sixth Circuits correctly recognized that the generic nature of these sooner-rather-than-later allegations makes them inadequate to support a claim under *Dudenhoeffer*. In *Martone v. Robb*, for instance, the Fifth Circuit considered a similar suit by the same lawyer alleging that Whole Foods's ESOP fiduciaries violated their duty of prudence by failing to disclose alleged fraudulent overpricing. 902 F.3d at 521-22. The plaintiff there likewise alleged that any prudent fiduciary would have disclosed the fraud earlier because "the longer [the] fraud … persists, the harsher the correction is likely to be when that fraud is finally revealed." *Id.* at 526.

The Fifth Circuit correctly rejected that "generalized allegation" as insufficient under *Dudenhoeffer*. *Id.* Because the sooner-rather-than-later allegation could be made "in virtually every fraud case," it "is not the sort of specific factual allegation that can distinguish" plausible sheep from meritless goats. Indeed, the Fifth Circuit specifically pointed to the complaint here, which "made essentially the same argument for early disclosure," as reinforcing the generic nature of the allegation. *Id.* at 526 & n.25.

The Sixth Circuit reached the same conclusion in *Graham v. Fearon*, 721 F. App'x 429 (6th Cir. 2018), another case brought by respondents' counsel. Like respondents, the plaintiffs in *Graham* claimed that the defendant ESOP fiduciaries should have made earlier corrective disclosures, and relied on the generic allegation that "the longer a securities fraud goes on,

the more harm it causes to shareholders." *Id.* at 435-36. Unlike the panel here, however, the Sixth Circuit correctly held that allegation insufficient.

The generic sooner-rather-than-later assertion, the Sixth Circuit explained, "does not account for the risk of market overreaction to such a disclosure," and fails to "factor in the potential harm to ESOP participants planning to sell their [company] stock during the class period." *Id.* at 436. Absent more specific factual allegations about "the circumstances then prevailing," 29 U.S.C. §1104(a)(1)(B), the generalized allegation that earlier disclosure would minimize reputational damage was insufficient to "plausibly allege … that a prudent fiduciary could not conclude that [earlier disclosure] would be more likely to harm the fund than to help it," *Graham*, 721 F. App'x at 436; *accord Wilson v. Edison Int'l, Inc.*, 315 F. Supp. 3d 1177, 1193 (C.D. Cal. 2018) (allegations that "the longer a fraud goes on, the harsher the correction" are "framed in a manner that could apply to any similar ERISA claim" and so "do not withstand the 'context-sensitive' scrutiny under [*Dudenhoeffer*]"); *Fentress v. Exxon Mobil Corp.*, 304 F. Supp. 3d 569, 583 (S.D. Tex. 2018); *Price v. Strianese*, 2017 WL 4466614, at *7-8 (S.D.N.Y. Oct. 4, 2017); *In re JPMorgan Chase & Co. ERISA Litig.*, 2016 WL 110521, at *4 (S.D.N.Y. Jan. 8, 2016).

The inadequacy of that generic allegation is even more obvious here, where the plan was a net seller during the class period. Pet.App.35a. As the Sixth Circuit underscored in *Graham*, a plan fiduciary for an ESOP that includes participants who are selling company stock needs to be concerned about "market

overreaction" to a dramatic and extraordinary disclosure of adverse information. Particularly given the certainty that would-be sellers will be harmed by early disclosure and the relative uncertainty of the market's reaction to eventual disclosure, a prudent fiduciary for an ESOP that is a net seller could quite prudently conclude that immediate disclosure would do "more harm than good to the fund." *Dudenhoeffer*, 573 U.S. at 430. Generic allegations about "reputational damage" from delayed disclosure are hardly an answer to the dilemma faced by a plan fiduciary in that situation and are hardly sufficient to plausibly allege that a failure to disclose immediately is imprudent.

b. The Second Circuit also relied on respondents' related allegation that the disclosure here was "inevitable," which it viewed as "particularly important." Pet.App.19a. According to the panel, when the eventual disclosure of an alleged fraud is inevitable, "it is far more plausible that a prudent fiduciary would prefer to limit the effects of the stock's artificial inflation … through prompt disclosure." Pet.App.19a. But the inevitability of disclosure is just the corollary of the sooner-rather-than-later allegation. After all, if the eventual disclosure of fraud were not inevitable, then voluntary disclosure sooner-rather-than-later would not always be the prudent course. For this reason, the plaintiffs here and in *Martone* and *Graham* linked allegations that "no fraud lasts forever" with allegations that early disclosure is always the prudent course. *See* J.A.97, 142; Am. Class Action Compl. ¶¶8, 89, *Martone v. Robb*, No. 15-cv-877 (W.D. Tex. filed Oct. 14, 2016), Dkt.41; Class Action Compl. ¶¶8, 86, *Graham v.*

Fearon, No. 16-cv-2366 (N.D. Ohio filed Sept. 23, 2016), Dkt.1.

Thus, disclosure-is-inevitable allegations add nothing to the sooner-rather-than-later allegations and suffer all the same problems. They do nothing to address the reality that IBM's ESOP was a net seller or to distinguish one stock-drop case from another. Since every stock-drop complaint will follow a drop in the stock price associated with an actual disclosure, it will always be easy to allege that the disclosure that did, in fact, occur was inevitable. Indeed, respondents plead in their own complaint that the eventual disclosure of any fraud is "always" inevitable. J.A.142 ("[N]o corporate fraud lasts forever; there is always a day of reckoning."); J.A.97 ("[N]o fraud lasts forever."). Unsurprisingly, the same allegations of "inevitable" discovery were in fact made *in haec verba* (and through the same counsel) in *Martone* and *Graham*, *see* Pet.17 & n.10.

To be sure, respondents alleged distinct *reasons* why the disclosure here was inevitable—namely, the impending sale of Microelectronics. *See* Pet.App.19a. But it will always be possible (especially in retrospect) to allege some case-specific details for *why* the disclosure that actually occurred was inevitable all along. Adding those details does not make the underlying assertion that disclosure was "inevitable" any less generally applicable. Nor does the prudence of the fiduciary's decision to decline to disclose turn on the precise mechanics of how the disclosure occurred or why that disclosure was purportedly inevitable.

Finally, the specific allegations here actually undermine the notion that disclosure was inevitable.

Even assuming that a sale of the Microelectronics assets would make disclosure of their alleged overvaluation inevitable, the actual sale was far from certain, let alone inevitable. IBM would only sell the assets to a buyer willing to enter a long-term supply agreement with IBM. After long and uncertain negotiations, IBM eventually found a purchaser willing to enter such an agreement, but that was far from inevitable. Thus, the Second Circuit's reliance on the case-specific details of why disclosure was supposedly inevitable was not only legally irrelevant, but factually dubious, especially if one considers only the information available to the fiduciary at the time, as ERISA demands. If IBM had never found a suitable buyer, then disclosure would not be inevitable. That uncertainty provides one more reason a prudent fiduciary could have—indeed, would have—decided to avoid the immediate harm to the fund from disclosure.[5]

c. The Second Circuit's error in finding these generalized allegations sufficient is dramatically underscored by the fact that no other court has ever found a viable duty-of-prudence claim under *Dudenhoeffer* based on allegations that an ESOP fiduciary should have disclosed inside information

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[5] For all the reasons set forth above, *see* pp.34-44, *supra*, petitioners submit that the proper standard for evaluating duty-of-prudence claims in this context is the "could not have" standard, rather than a "would not have" standard. But given the ESOP's status as a net seller and the uncertainty over whether a sale of the Microelectronics assets could be consummated, the allegations here are insufficient to plausibly allege a duty-of-prudence standard under either standard.

earlier.[6] On the contrary, courts have routinely dismissed such allegations. *See, e.g.*, *Martone*, 902 F.3d at 526-27; *Laffen v. Hewlett-Packard Co.*, 721 F. App'x 642, 644 (9th Cir. 2018); *Graham*, 721 F. App'x at 435-37; *Saumer*, 853 F.3d at 864; *Whitley*, 838 F.3d at 528-29; *Loeza v. John Does 1-10*, 659 F. App'x 44, 45-46 (2d Cir. 2016); *Rinehart v. Lehman Bros. Holdings Inc.*, 817 F.3d 56, 68 (2d Cir. 2016); *Wilson*, 315 F. Supp. 3d at 1192-93; *Fentress*, 304 F. Supp. 3d at 583-84; *Price*, 2017 WL 4466614, at *7-8; *JPMorgan*, 2016 WL 110521, at *4.

That is for good reason. As *Dudenhoeffer* itself recognized, a prudent fiduciary could often conclude that "publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price and a concomitant drop in the value of the stock already held by the fund." 573 U.S. at 430; *see Amgen*, 136 S. Ct. at 759. Because an ESOP fiduciary owes his duties to all the "participants and beneficiaries" of the fund as a whole, 29 U.S.C. §1104(a)(1), not just participants who are net buyers, any prudent fiduciary must balance the benefit of a corrective disclosure (allowing new purchases at a lower price) against the immediate harm to all plan participants of a steep drop in their existing holdings. In the vast majority of cases, a prudent fiduciary could easily conclude that even if eventual disclosure is

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[6] The other allegations on which the panel below relied—that petitioners were aware of the alleged fraud, that they had the power to reveal it, and that the stock traded in an efficient market, *see* Pet.App.15a-16a, 18a-19a—could likewise be made in practically any case, and so do not satisfy the "careful, context-sensitive scrutiny" that *Dudenhoeffer* requires. 573 U.S. at 425.

inevitable, it would be better for the fund as a whole to have that disclosure (and the accompanying loss in value) come later rather than earlier—especially as there is always at least some chance that even a supposedly "inevitable" disclosure will be overtaken by events. And again, that is especially true in *this* case, where the plan was a net seller during the class period and so on average its transactions *benefited* from the stock having a higher price.

This context underscores why, in order to state a plausible claim that an ESOP fiduciary violated his duty of prudence by failing to disclose negative inside information earlier, a complaint must provide adequate factual allegations to show that it is one of the rare cases in which a prudent fiduciary "could not have concluded" that earlier disclosure "would do more harm than good" to the fund as a whole. *Dudenhoeffer*, 573 U.S. at 430. That is not an impossible threshold; there may well be situations where all prudent fiduciaries would agree that earlier disclosure is better than later, such as where a new ESOP had not yet begun to purchase company stock and so a drop in the stock price could not harm existing participants. But in the mine-run stock-drop case, a prudent fiduciary could readily conclude that the certain costs of immediate disclosure will outweigh the uncertain costs of later disclosure and thus will do more harm than good to the fund. For that reason, to plausibly allege an imprudent action, the burden is on the plaintiff to point to distinct characteristics of the case at hand that take delayed disclosure outside the range of possible prudent choices. Respondents in their complaint here have not come close to carrying that burden.

III. Allowing The Decision Below To Stand Would Eviscerate *Dudenhoeffer* And Threaten Serious Practical Consequences.

The stakes here are considerable. If duty-of-prudence claims can readily survive motions to dismiss, then corporations will think twice about offering ESOPs despite Congress' clear interest in promoting them. If the cost of having corporate insiders serve as plan fiduciaries is inevitable litigation, then corporations will refrain from having corporate insiders serve as plan fiduciaries despite Congress' clear authorization of the practice and the considerable benefits of that commonplace arrangement. And if courts must fashion an *ad hoc* ERISA disclosure regime from common law trust principles to supplement the finely calibrated disclosure regime of the securities laws, the objectives of those laws will clearly be frustrated, and there is a danger that the *ad hoc* regime will supplant the existing regime. On the other hand, if this Court reaffirms that a plausible breach-of-duty claim in this context is a *rara avis*, then Congress' intent and the objectives of the securities-law disclosure regime will both be honored.

1. Allegations that insider fiduciaries should have made an earlier disclosure are easy to make in the wake of a stock-price drop and costly to disprove. The presence of insiders and the reality of a price drop provide ample incentives to file a complaint. And if a securities-law complaint has already been filed, an ERISA lawyer need do little more than cut and paste. The numbers bear this out. In the years before *Dudenhoeffer* was decided (and even with the

protection of the since-discarded presumption of prudence), ESOP fiduciaries faced hundreds of ERISA stock-drop suits. *See ERISA Company Stock Cases*, Cornerstone Research, https://bit.ly/2LVMuxK (last visited Aug. 6, 2019) (reporting over 250 ERISA stock-drop cases filed from 1997 to 2014). *Dudenhoeffer* and *Amgen* have succeeded in preventing meritless duty-of-prudence claims from proceeding past the pleading stage. But if the decision below stands, it will eliminate that protection, allowing plaintiffs to escape dismissal through generalized allegations and exposing ESOP fiduciaries and plans to the heavy costs of discovery or *in terrorem* settlements in baseless suits.

Those litigation costs would cause many companies to reconsider offering ESOPs, which would frustrate Congress' repeatedly expressed intent in promoting employee stock ownership. *See*, *e.g.*, 90 Stat. at 1590 (warning against "rulings which … reduce the freedom of the employee trusts and employers to … implement [ESOPs], and which otherwise block the establishment and success of these plans"). Other companies might maintain their ESOPs but shift fiduciary responsibilities to corporate outsiders with no access to inside information. That shift would not only mean the abandonment of a common arrangement that Congress has expressly authorized, *see* 29 U.S.C. §1108(c)(3), but would further increase costs and would deprive ESOPs of the benefits of fiduciaries with significant experience at the company. *See* John L. Utz, *Internal Trustees of ESOPs* 11 (Aug. 25, 2015), *available at*

https://bit.ly/31hrHZk (describing advantages of company officers as ESOP fiduciaries).[7]

2. Allowing the decision below to stand would also create an obvious end-run around the strict standards that Congress has enacted to rein in abusive securities litigation. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) (describing the "[e]xacting pleading requirements" that Congress enacted in the PSLRA "[a]s a check against abusive litigation"). As noted, when there is a stock-price drop occasioned by the disclosure of adverse information, a securities action often follows, with a tag-along ERISA claim filed as well. This case itself provides a prime example of that common pattern and how affirmance would undermine Congress' effort to weed out meritless stock-drop suits. In the wake of a drop in IBM's share price, two sets of plaintiffs brought two putative class actions premised on the alleged fraud here: a securities fraud case (*Insulators*) and this ERISA case. The district court dismissed the securities fraud action for failure to meet the requirements of the PSLRA, *see Insulators*, 205 F.

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[7] This shift would also underscore that respondents' position would do nothing to benefit ESOP participants in the long run. After all, the gravamen of respondents' complaint is not that there is something problematic about a plan fiduciary with access to inside information, but that plan fiduciaries with access to such information must use that valuable information to benefit plan participants. If the inevitable result of respondents' position is that ESOPs will be administered by fiduciaries without access to valuable inside information that could be used to benefit plan participants, then plan participants will be no better off in the long run.

Supp. 3d at 537-38, and the plaintiffs did not even appeal that ruling, *see* Pet.App.4a.

In the decision below, however, the Second Circuit held that materially identical allegations were sufficient to state an ERISA duty-of-prudence claim premised on the very same alleged fraud. The panel recognized the effect of its decision, acknowledging as "not without merit" the concern that its ruling "would lead to an end run around the heightened pleading standards for securities fraud suits set out in the [PSLRA]." Pet.App.22a. But it did nothing to address that concern, beyond an inscrutable pronouncement that respondents "may not allege … that [petitioners] committed securities fraud" but only that they "knew about [Microelectronics'] overvaluation and failed to disclose it." Pet.App.24a.

By finding the generalized allegations here sufficient, the Second Circuit invited plaintiffs to reframe every unsuccessful securities fraud class action as an ERISA duty-of-prudence case. That approach reopens the door to the very same "frivolous, lawyer-driven" class action strike suits that the PSLRA was designed to end. *Tellabs*, 551 U.S. at 322. Under the decision below, there is no need for plaintiffs' lawyers to brave the daunting restrictions of the PSLRA.[8] As long as they can find a plan participant, they can simply rewrite their complaint to

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[8] That includes not only the PSLRA's heightened pleading standard, but also its limitations on damages and attorney's fees, its mandatory sanctions for frivolous litigation, and its stay on discovery pending resolution of any motion to dismiss. *See* 15 U.S.C. §78u-4; *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 476 (2013).

allege an ERISA claim. And if reframing those suits as ERISA claims will allow them to survive a motion to dismiss, the burden of discovery will allow the very "extraction of extortionate settlements of frivolous claims" that the PSLRA was meant to prevent. *Amgen Inc. v. Conn. Ret. Plans & Tr. Funds*, 568 U.S. 455, 475-76 (2013) (brackets omitted).

3. Finally, allowing the decision below to stand would "conflict with the complex … corporate disclosure requirements imposed by the federal securities laws [and] with the objectives of those laws." *Dudenhoeffer*, 573 U.S. at 429. As noted above, federal law already provides an elaborate disclosure regime, put in place by Congress and implemented by the SEC, to protect the markets and ensure adequate transparency. *See* pp.27-31, *supra*. But if plaintiffs can plausibly allege in every case (through generic allegations like those here) that plan fiduciaries had a duty under ERISA to make corrective disclosures earlier, the scope and timing of those disclosures will soon be governed more by judicial opinion than by the calibrated statutes and regulations that Congress and the SEC have designed. That would work the precise frustration of "the objectives" of the securities laws that this Court warned against in *Dudenhoeffer*. 573 U.S. at 429. The far better course is to leave the proper timing and scope of disclosure obligations for corporate insiders to the securities laws and reserve ERISA duty-of-prudence claims for the rare circumstance where it can plausibly be pled that a plan fiduciary pursued a course of action outside the range of prudent alternatives.

CONCLUSION

The Court should reverse the judgment of the Second Circuit.

Respectfully submitted,

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STATUTORY APPENDIX

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29 U.S.C. § 1104(a)

Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and--

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) 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;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III.

(2) In the case of an eligible individual account plan (as defined in section 1107(d)(3) of this title), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the

extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 1107(d)(4) and (5) of this title).

29 U.S.C. § 1107

Limitation with respect to acquisition and holding of employer securities and employer real property by certain plans

(a) Percentage limitation

Except as otherwise provided in this section and section 1114 of this title:

(1) A plan may not acquire or hold--

(A) any employer security which is not a qualifying employer security, or

(B) any employer real property which is not qualifying employer real property.

(2) A plan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

(3) (A) After December 31, 1984, a plan may not hold any qualifying employer securities or qualifying employer real property (or both) to the extent that the aggregate fair market value of such securities and property determined on December 31, 1984, exceeds 10 percent of the greater of--

(i) the fair market value of the assets of the plan, determined on December 31, 1984, or

(ii) the fair market value of the assets of the plan determined on January 1, 1975.

* * *

(b) Exception

(1) Subsection (a) of this section shall not apply to any acquisition or holding of qualifying employer securities or qualifying employer real property by an eligible individual account plan.

* * *

(d) Definitions

For purposes of this section--

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. A contract to which section 1108(b)(5) of this title applies shall not be treated as a security for purposes of this section.

(2) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, or to an affiliate of such employer. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to the employer (or affiliate) is entered into, whichever is later.

(3) (A) The term "eligible individual account plan" means an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on September 2, 1974, and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in section 408 of Title 26.

(B) Notwithstanding subparagraph (A), a plan shall be treated as an eligible individual account plan with respect to the acquisition or holding of qualifying employer real property or qualifying employer securities only if such plan explicitly provides for acquisition and holding of qualifying employer securities or qualifying employer real property (as the case may be). In the case of a plan in existence on September 2, 1974, this subparagraph shall not take effect until January 1, 1976.

(C) The term "eligible individual account plan" does not include any individual account plan the benefits of which are taken into account in determining the benefits payable to a participant under any defined benefit plan.

* * *

(5) The term "qualifying employer security" means an employer security which is--

(A) stock,

(B) a marketable obligation (as defined in subsection (e)), or

(C) an interest in a publicly traded partnership (as defined in section 7704(b) of Title 26), but only if such partnership is an existing partnership as defined in section 10211(c)(2)(A) of the Revenue Act of 1987 (Public Law 100-203).

After December 17, 1987, in the case of a plan other than an eligible individual account plan, an employer security described in subparagraph (A) or (C) shall be considered a qualifying employer security only if such employer security satisfies the requirements of subsection (f)(1).

(6) The term "employee stock ownership plan" means an individual account plan--

(A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified, under section 401 of Title 26, and which is designed to invest primarily in qualifying employer securities, and

(B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

* * *

29 U.S.C. §1108(c)(3)

Exemptions from prohibited transactions

(c) Fiduciary benefits and compensation not prohibited by section 1106

Nothing in section 1106 of this title shall be construed to prohibit any fiduciary from--

* * *

(3) serving as a fiduciary in addition to being an officer, employee, agent, or other representative of a party in interest.

29 U.S.C. §1109(a)

Liability for breach of fiduciary duty

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

29 U.S.C. §1132(a)(2)-(3)

Civil enforcement

(a) Persons empowered to bring a civil action

A civil action may be brought--

* * *

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title;

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this subchapter or the terms of the plan;