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

REPLY BRIEF FOR PETITIONERS

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The circuit split here is unusually stark. Respondents do not deny that the Fifth and Sixth Circuits rejected the same ERISA claims alleged here, premised on the same material allegations, brought by the same counsel. Indeed, the Fifth Circuit pointed to the complaint here as evidence that the same disclose-sooner-rather-than-later claim could be alleged in virtually every case, a result in conflict with *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014). That clear circuit conflict and the conflict between the Second Circuit and *Fifth Third* plainly warrant the Court's review. Not only is the split undeniable, but the issue is important. Respondents concede that a securities suit raising the same basic allegations was dismissed, opening the door for the routine repleading of claims eliminated by the Private Securities Litigation Reform Act (PSLRA) as ERISA actions. Given ERISA's liberal venue rules and New York's centrality to the financial markets, the stakes are high.

Respondents insist that the Second Circuit's decision purportedly turned on case-specific allegations and deny that suits like this should be rare. But Respondents' allegations could be repeated in any case—and were made in the Fifth and Sixth Circuit cases—and any suggestion that such suits should be easy to allege contradicts both the thrust of this Court's decision in *Fifth Third* and Congress' judgment that Employee Stock Ownership Plans (ESOPs), and not frivolous suits against ESOP fiduciaries, are what should proliferate. This Court should grant plenary review.

I. The Courts Of Appeals Are Split Over The Same Allegations By The Same Lawyer.

The circuit split on the question presented is unmistakable. In the Fifth and Sixth Circuits, allegations that the harm from an undisclosed fraud only grows over time, and so disclosure sooner rather than later is necessarily preferable, are insufficient under *Fifth Third*. *See Martone v. Robb*, 902 F.3d 519 (5th Cir. 2018); *Graham v. Fearon*, 721 F. App'x 429 (6th Cir. 2018). In the Second Circuit, however, those same allegations (pleaded by the same counsel) are sufficient to satisfy *Fifth Third* and open the doors to discovery. App.15a-21a. As other courts have recognized, the decision below "directly contradicts" the law in the Fifth and Sixth Circuits, "which rejected an identical argument." *Fentress v. Exxon Mobil Corp.*, 2019 WL 426147, at *5 (S.D. Tex. Feb. 4, 2019); *see* Chamber.Br.13-14.

Respondents' attempts to disguise this square split are unpersuasive. They begin with a red herring, suggesting that the Second Circuit "went out of its way to make clear" that it had "appl[ied] the … pleading standard endorsed by the Fifth and Sixth Circuits." Opp.11-12. But the fact that the Second Circuit declined to open up a *different* split (that the petition did not allege) does nothing to eliminate the split that the Second Circuit did create (and was the subject of the petition). The very passage that Respondents cite, App.14a-15a, makes clear that the panel below was refraining from taking sides on a different question: whether plaintiffs must allege that a prudent fiduciary "*would* not have" concluded that an alternative action would do more harm than good, or instead "*could* not have" concluded as much. App.10a-11a (quoting *Fifth Third*, 573 U.S. at 428-30).

On that threshold question, the panel assumed that the "could not have" standard previously adopted by the Fifth and Sixth Circuits should apply. App.14a-15a (citing cases). But that just makes the split here all the more striking: Despite starting from the same premise as the Fifth and Sixth Circuits that plaintiffs must show a prudent fiduciary "could not have" plausibly thought that immediate disclosure was imprudent, the Second Circuit found generalized allegations that the harm of an undisclosed fraud grows over time sufficient to meet that standard, while the Fifth and Sixth Circuits reached the opposite conclusion on materially identical allegations filed by the same attorney. *Compare* App.16a-18a, *with Martone*, 902 F.3d at 526-27, *and Graham*, 721 F. App'x at 435-37.[1]

Respondents next try to characterize the decision below as turning on the "particular set of factual allegations" in this case. Opp.10, 16. There are multiple problems with that submission, not the least of which is that no one else who has read the Fifth, Sixth and Second Circuit decisions agrees with Respondents, starting with the Fifth Circuit. In affirming the dismissal of a complaint raising the same basic sooner-rather-than-later claims filed by the same lawyer, the Fifth Circuit specifically

[1] While the would-vs.-could question is not directly presented by the petition, the lower court confusion on that question stems from slightly different language in various passages of *Fifth Third*. Thus, this Court could readily clarify that matter in the course of addressing the question presented.

adverted to the complaint here (and in *Graham*) as underscoring the ease with which these allegations could be made routinely in the wake of a stock drop. *See Martone*, 902 F.3d at 526-27 & n.25. As noted, a district court reviewed the decisions and concluded that the decision below "directly contradicts" the Fifth Circuit decision in *Martone*. *Fentress*, 2019 WL 426147, at *5. Third-party amici reached the same conclusion. Chamber.Br.13-14.

A careful reading of the Second Circuit decision confirms that it did not turn on case-specific allegations. As Respondents acknowledge, the Second Circuit relied on five factual allegations to find that Respondents had stated a claim. App.15a-20a; *see* Opp.6-7. There is no dispute that four of those five allegations—that defendants knew of the alleged fraud, that they had the power to disclose it, that the stock traded in an efficient market, and that the harm from eventual disclosure grows over time, App.15a-19a—are generalized allegations that could be made by any plaintiff alleging that ESOP fiduciaries should have made an earlier disclosure about a publicly traded stock. Indeed, Respondents acknowledge the "general" nature of these allegations, Opp.ii, 11, 16, and admit (with considerable understatement) that they are "potentially applicable to other cases," Opp.9. In fact, the Second Circuit itself observed that Respondents' fourth allegation—that the harm from eventual disclosure grows over time—"could be made by plaintiffs in any case." App.17a.

Although Respondents claim that their fifth allegation—that eventual disclosure was inevitable—is "[p]articular[]," "specific," or "unique," Opp.4, 8, 9, their own allegations are to the contrary. As Respondents asserted in their complaint, "[N]o corporate fraud lasts forever; there is always a day of reckoning." SAC ¶112; *see also id.* ¶8 ("[D]efendants knew, or should have known, that no fraud lasts forever."). In fact, unsurprisingly, the same allegations were made *in haec verba*—and through the same counsel—in *Martone* and *Graham*. *See* Am. Compl. ¶89, *Martone v. Robb*, No. 1:15-cv-877 (W.D. Tex. Oct. 14, 2016), ECF No.41 ("[N]o corporate fraud lasts forever; there is always a day of reckoning."); *id.* ¶8 ("Defendants knew, or should have known, that no fraud lasts forever."); Compl. ¶¶8, 86, *Graham v. Fearon*, No. 1:16-cv-2366 (N.D. Ohio Sept. 23, 2016), ECF No.1 (same). The only difference is that the Second Circuit found those allegations sufficient and the Fifth and Sixth Circuits did not.

Perhaps recognizing that "inevitability" can be alleged in any case, Respondents emphasize that the *reason* that disclosure was inevitable here—the pending sale of IBM's purportedly impaired Microelectronics unit—is distinct. In Respondents' view, "IBM's efforts to sell Microelectronics … made disclosure of the value of Microelectronics inevitable in a way unique to the facts of this case." Opp.11. But this gets Respondents nowhere. Every case has its own facts and its own details about why disclosure was inevitable—whether an impending sale of an impaired business unit, discovery by auditors, regulatory enforcement, whistleblowers, or even investigative journalism. Indeed, every stock-drop case will follow an actual disclosure (that prompted the price drop), and so it will always be possible to allege some case-specific details concerning how the actual disclosure was inevitable all along. But the details of why the day of reckoning was inevitable are not what causes the ERISA fiduciary to violate the duty of prudence. Rather, the generalized allegations that the disclosure was inevitable and that the harm increased over time by themselves make the fiduciary's failure to disclose earlier actionable, as both the Second Circuit and Respondents ultimately acknowledge. But such generalized allegations cannot be actionable without eliminating the ability of the *Fifth Third* pleading standard to "divide the plausible sheep from the meritless goats." 573 U.S. at 425. For precisely that reason, the Fifth and Sixth Circuits rejected such allegations as inadequate, yet the Second Circuit allowed a complaint that the Fifth Circuit viewed as "essentially the same" to proceed. *Martone*, 902 F.3d at 526.

As a fallback position, Respondents suggest that the 2-1 split is "shallow" and the issue should percolate further. Opp.16-17. But there is nothing "shallow" about three circuits looking at materially identical allegations by the same counsel and allowing the claims to go forward in New York, but not in New Orleans or Cincinnati. And now that the Second Circuit has decided to permit duty-of-prudence suits based on generalized allegations like those here, further percolation is not just unnecessary but unlikely, since future plaintiffs will rely on ERISA's liberal venue provision to bring their claims in the home court of the Nation's securities markets and take advantage of its favorable law. *See* Pet.21-22 & n.13; Chamber.Br.17.[2]

Finally, Respondents briefly remark that the case is "interlocutory," Opp.19, but that just underscores the circuit split: the Fifth and Sixth Circuits definitively rejected comparable allegations as inadequate while the Second Circuit allowed the suit to proceed (reversing a decision dismissing it). The only reason the Fifth and Sixth Circuit decisions were final dismissals and this case is interlocutory is that the circuits are split. This Court routinely reviews—and reverses—decisions in this posture, including in the ERISA context. *See Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016) (per curiam); *see also, e.g.*, *Ziglar v. Abbasi*, 137 S. Ct. 1843 (2017); *RJR Nabisco, Inc. v. European Cmty.*, 136 S. Ct. 2090 (2016); *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540 (2016). In short, there is every reason for this Court to grant the petition and resolve this circuit conflict now.

II. The Decision Below Cannot Be Reconciled With *Fifth Third.*

The decision below not only creates a circuit split, but also is fundamentally wrong. By accepting as sufficient allegations that the harm of an undisclosed fraud grows over time and that eventual disclosure is inevitable, the decision below eviscerates the rigorous pleading standard that this Court established in *Fifth*

[2] The pending cases Respondents cite (at Opp.17) as justifying further percolation only underscore the ease with which comparable allegations can be made. The presence of materially identical suits pending in other circuits thus reinforces the problems with the Second Circuit's decision and is a reason to grant plenary review, not defer it.

Third and gives a green light to the kind of "meritless, economically burdensome lawsuits" that standard was designed to prevent. *Fifth Third*, 573 U.S. at 424.

Respondents acknowledge that *Fifth Third* was designed to stop plaintiffs from just "copy[ing] and past[ing] generic allegations regarding 'inevitable' disclosure." Opp.18. But their only response is to once again emphasize their "specific allegations regarding IBM's efforts to sell Microelectronics." *Id.* As explained, however, allegations concerning the particular *reason* that disclosure of the fraud is "inevitable" do not add anything material to the equation. Every one of these stock-drop cases will involve an alleged fraud that was, in fact, disclosed to the market (hence, the price drop), so it will always be possible to add some detail about why the eventual disclosure was inevitable all along. If that were enough to satisfy the *Fifth Third* pleading standard, then that standard would fall well short of its promise to "divide the plausible sheep from the meritless goats." 573 U.S. at 425. In reality, Respondents' reliance on the inevitability of disclosure does nothing to distinguish likely meritorious cases and would force fiduciaries, who could never be certain that nonpublic information would not eventually come out, to disclose or face a lawsuit in every case.

Tellingly, Respondents eventually reveal that they would welcome that outcome. Despite recognizing that the standard established in *Fifth Third* was designed "to weed out meritless lawsuits," Opp.22 (quoting *Fifth Third*, 573 U.S. at 425), they suggest that lower courts (presumably including the Fifth and Sixth Circuits in *Martone* and *Graham*) have gone too far, turning the search for meritorious sheep into a quest for "black swans" and effectively recreating the presumption of prudence rejected in *Fifth Third*. Opp.22-23. But *Fifth Third* did not adopt a rigorous pleading standard just so it could be satisfied by generic allegations that could be made in every case. Instead, *Fifth Third* alluded to "special circumstances" that may distinguish a viable claim from a generic stock-drop scenario, providing the example of a thinly-traded stock. 573 U.S. at 426. Similarly, following *Fifth Third*, courts have permitted duty-of-prudence claims to proceed on allegations that ESOP fiduciaries failed to adequately investigate the value of private stock, *see Allen v. GreatBanc Trust Co.*, 835 F.3d 670, 678-80 (7th Cir. 2016), or invested in a company that was clearly "headed for bankruptcy," *Gedek v. Perez*, 66 F. Supp. 3d 368, 371 (W.D.N.Y. 2014). The generalized allegations here (and in *Martone* and *Graham*) are not comparable.

Ultimately, Respondents' view that the narrow gate of *Fifth Third* should be widened to allow in some goats cannot be squared with either *Fifth Third* or the congressional judgments honored in that decision. There is, after all, an easy way for corporations to avoid this kind of stock-drop suit: They can discontinue ESOPs and deny employees the option of owning a stake in the company. By eliminating ESOPs, companies can preclude allegations that the insiders who serve as plan fiduciaries knew more than the market and should have disclosed sooner rather later. Needless to say, Congress made a deliberate judgment to encourage ESOPs and did not simultaneously intend the general ERISA remedies to frustrate that specific judgment. This Court recognized all that in *Fifth Third* and developed a pleading standard designed to make duty-of-prudence stock-drop suits the exception and not the rule. Until the decision below, the *Fifth Third* standard has operated as intended, protecting ESOP plans from meritless lawsuits and *in terrorem* settlements. *See* Chamber.Br.11-13. If the balance set by *Fifth Third* is to be revisited, it must be by Congress or this Court, not by the Second Circuit.[3]

III. The Decision Below Will Have Far-Reaching And Deleterious Implications.

The Second Circuit's decision will impose serious burdens on companies, ESOP fiduciaries, and plan participants. Allowing plaintiffs to survive a motion to dismiss through generalized allegations that the harm from an undisclosed fraud grows over time, and that disclosure is inevitable, will encourage plaintiffs to bring unfounded ERISA suits in the Second Circuit just to extract expensive settlements. *See* Pet.21-22; Chamber.Br.16-17. And indeed, plaintiffs have begun doing just that in the wake of the decision below. *See* Compl. at 16-17, *Varga v. GE Co.*, No. 1:18-cv-1449 (N.D.N.Y. Dec. 14, 2018) (complaint filed shortly after decision below issued, relying on similar boilerplate

[3] Despite Respondents' footnote, Opp.23 n.2, the decision below is irreconcilable with *Pegram v. Herdrich*, 530 U.S. 211 (2000). Respondents claim that Petitioners should have "tried to use financial reporting under the securities laws" to disclose the alleged fraud. Opp.23 n.2. But Petitioners could only have done so in their *non-fiduciary* corporate capacities; thus, any claim based on the failure to make such disclosures conflicts with *Pegram*. *See* 530 U.S. at 225-26; Pet.17 n.9.

allegations that disclosure was inevitable and earlier disclosure is always preferable).[4]

Still worse, as this very case demonstrates, the Second Circuit's decision will allow creative lawyers to plead around the strict requirements that Congress has imposed on securities fraud cases via the PSLRA by simply reframing their cases as ERISA actions. Pet.23-25. The resulting litigation will impose significant costs on companies and plan participants, and frustrate Congress' judgments in encouraging ESOPs and enacting the PSLRA. Pet.22-23; Chamber.Br.15, 17-18.

Respondents have no substantial answer to these concerns, largely because they think additional duty-of-prudence suits would be a good thing. Regarding the concern that the decision below invites the repleading of meritless securities claims as ERISA actions, Respondents do not dispute that the parallel securities fraud class action here was properly dismissed. *See* App.4a, 21a-24a. Instead, they suggest that allowing ERISA actions to proceed when parallel securities actions cannot is just an inevitable consequence of Congress' decision to limit the PSLRA to securities actions. Even the Second Circuit had qualms about that result: allowing this ERISA suit to

[4] Respondents inexplicably cite *Fentress*—in which the complaint was filed before the decision below issued—as evidence that the decision will not open the floodgates. Opp.21. But the fact that *Varga* was filed in the Second Circuit and *Fentress* dismissed a suit filed in the Fifth Circuit just highlights the circuit split, *Fentress*, 2019 WL 426147, at *5 (recognizing that Second Circuit's decision "directly contradicts" Fifth Circuit's standard), and that the Second Circuit will become the forum of choice for similar suits going forward.

go forward on "essentially the same facts" would allow "an end run around the heightened pleading standards for securities fraud suits." App.22a (recognizing this concern is "not without merit").

This Court already supplied the solution to this end run in the form of *Fifth Third*'s rigorous pleading standard. In the hands of the Fifth and Sixth Circuits, that pleading standard has proven sufficient to prevent frivolous lawsuits and the repackaging of securities claims as ERISA actions. The problem here lies not in *Fifth Third* or Congress' failure to extend the PSLRA to ERISA stock-drop actions, but with the Second Circuit's decision that unambiguously allows an ERISA action to proceed on the same facts as a failed securities action that was stopped in its tracks. To prevent that result and to preserve the "careful, context-sensitive scrutiny" that *Fifth Third* requires, 573 U.S. at 425, this Court should grant certiorari.

CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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