

Justices Set Sights On ESOP Stock-Drop Suits

By **Danielle Nichole Smith**

Law360 (June 4, 2019, 8:10 PM EDT) -- IBM workers who alleged the overseers of their employee stock ownership plan let them invest in overvalued company stock may need to brace for a reversal of the Second Circuit's revival of their suit now that the nation's highest court has agreed to review the case.

If the U.S. Supreme Court sides with an IBM retirement committee and shuts down the Second Circuit's revival of the proposed Employee Retirement Income Security Act class action — as some attorneys predict the court will — the decision could be, in the words of Bailey & Glasser LLP's Mark G. Boyko, the “last nail in the coffin” for such claims against publicly traded ESOPs.

While a decision backing the Second Circuit's finding could breathe new life into those cases, which haven't fared well since the Supreme Court's 2014 decision in *Fifth Third Bancorp. v. Dudenhoeffer, Cohen Milstein Sellers & Toll PLLC*'s employee benefits group Chair Karen Handorf is doubtful the high court granted the committee's petition on Monday with that intention.

“Optimistically, I would like to believe that the Supreme Court was going to take it and clarify that you actually can plead such a case, I just don't think that's what they're going to do,” Handorf told Law360.

At the center of the suit is the “more harm than good” pleading standard that was established in the Supreme Court's *Fifth Third Bancorp* ruling. In that decision, the high court held that ESOP participants could only allege their plan's fiduciaries breached their duty of prudence based on inside information by demonstrating there was a legal alternative action available that the fiduciaries could not have concluded would do more harm than good to the plan.

The creation of the “more harm than good” standard has made it exceedingly difficult for suits against ESOPs claiming a company's stock price was artificially inflated to make it past the motion-to-dismiss stage. But that changed in December 2018 when the Second Circuit revived the IBM workers' suit alleging the company flouted ERISA by letting them invest their retirement savings in its stock while knowing that its microchip division was losing \$700 million per year.

The appeals court found that the workers had satisfied the pleading burden established in *Fifth Third Bancorp* by pointing to alternatives their fiduciary could have taken, such as notifying them about the microelectronic business's losses or freezing company stock from further investment.

For Handorf, the ruling came as a bit of a surprise, she said.

"I think most people had kind of given up on employer stock cases and then all of a sudden they seemed to have new life," Handorf said.

If the Supreme Court reverses that decision, Handorf said, it would be hard to imagine what complaint could meet the "more harm than good" standard. And if a plaintiff can't plead a fiduciary breach claim that could ever survive a motion to dismiss, then no one would bring cases and fiduciaries would be free to do whatever they wished, Handorf contended.

W. Michael Gradisek, on the other hand, told Law360 that allowing the ruling to stand would result in a flood of costly litigation and settlements since everyone's claims would always survive dismissal. Gradisek, the chair of Duane Morris LLP's employee benefits and executive compensation practice, said that he was "just a little surprised" that the Second Circuit would "go so far afield of Dudenhoeffer."

"Dudenhoeffer might be a little hard, but I think it's hard because you're trying to protect trustees and fiduciaries of a plan that really does provide a really generous benefit for employees," Gradisek said. "It's a pretty tough role to be a fiduciary of an ESOP, and I think they do need some additional protections."

Mayer Brown LLP's Nancy G. Ross predicted that the Supreme Court's eventual ruling in the IBM case will clarify "exactly what it was pronouncing in Dudenhoeffer." Ross, who co-chairs the firm's ERISA litigation practice, agreed that the Second Circuit's decision seemed to fly in the face of the high court's precedent, saying that it was hard to understand what the appeals court was thinking.

"It wasn't difficult to understand what they were saying, but I found it very difficult to reconcile that decision with Dudenhoeffer," Ross said. "I didn't see anything that warranted a different decision than the other publicly traded stock decisions in the ERISA space."

Ross said that the plan participants are the ones who are truly hurt by ambiguity surrounding ESOP fiduciaries' obligations. When fiduciaries can't get clarity about the risk involved for an investment option, that option could end up getting dropped, Ross said.

But Boyko told Law360 that courts had used the Fifth Third Bancorp decision to "pin the pendulum in favor of fiduciaries." If the Supreme Court rules in favor of the IBM workers, it could "bring the pendulum back into an alignment balancing the competing interests in prudent plan investments," Boyko said.

"But I certainly can't predict if they're going to bring it back to balance or if they're just going to sort of cut the cord and let the wrecking ball hit what it's going to hit," Boyko said.

--Editing by Emily Kokoll and Jack Karp.