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 A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF *AMICI CURIAE* CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, AMERICAN BENEFITS COUNCIL, AND ERISA INDUSTRY COMMITTEE IN SUPPORT OF PETITIONERS

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INTEREST OF AMICI CURAE[1]

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It directly represents 300,000 members and indirectly represents the interests of more than 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of concern to the nation's business community.

The American Benefits Council (the "Council") is a national non-profit organization dedicated to protecting and fostering privately sponsored employee benefit plans. Its approximately 440 members are primarily large, multistate employers that provide employee benefits to active and retired workers and their families. The Council's membership also includes organizations that provide employee-benefit services to employers of all sizes. Collectively, the Council's members either directly sponsor or provide services to retirement and health plans covering virtually every American who participates in employer-sponsored benefit programs.

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[1] No counsel for a party authored this brief in whole or in part and no person other than amici and their members made a monetary contribution intended to fund its preparation or submission. Pursuant to Supreme Court Rule 37.2, counsel of record for all parties received notice of amici's intent to file this brief more than 10 days before the due date, and all parties have provided written consent for amici to file this brief.

The ERISA Industry Committee ("ERIC") is a national nonprofit organization representing the nation's largest employers that sponsor employee benefit plans for their workers, retirees, and families. ERIC is the only national association that advocates exclusively for large employer plan sponsors on health, retirement, and compensation public policies at the federal, state, and local levels. ERIC members are leaders in every sector of the economy. As the voice of large employer plan sponsors on public policies affecting their ability to provide benefits to millions of active workers, retired persons, and their families nationwide, ERIC frequently participates as amicus curiae in cases that have the potential for far-reaching effects on employee benefit plan design or administration.

The Chamber, the Council, and ERIC (collectively, "Amici") frequently participate as amici curiae in cases like this one with the potential to significantly affect the design and administration of employee benefit plans under the Employee Retirement Income Security Act of 1974 ("ERISA"). Many of Amici's members offer their employees the opportunity to invest in employer stock funds like the one at issue in this case. Both the companies that design plans offering such funds and the fiduciaries who administer those plans have a significant interest in the standard by which their actions are reviewed. If the decision below is permitted to stand, plan sponsors are more likely to discontinue offering employer stock funds because their risk of ERISA liability and the costs of defending claims would be too great in the event of an ordinary downturn in the stock market.

Accordingly, Amici file this brief to aid the Court in its understanding of the issues presented in the petition and the deleterious impact that denying the petition could have on retirement plans that offer employer stock as an investment option.

SUMMARY OF ARGUMENT

This petition presents an important question affecting thousands of American companies, millions of their employees, and hundreds of billions of dollars in retirement investments. The decision below undercuts *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014), and creates a Circuit split by holding that *Dudenhoeffer*'s context-sensitive pleading standard can be satisfied by mere generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time. If left to stand, the decision would make it significantly easier for plaintiffs to survive a motion to dismiss and proceed into costly discovery when bringing baseless claims challenging a company's decision to offer an employee stock ownership plan ("ESOP")[2] among the investment options in an ERISA plan.

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[2] This brief refers to funds investing in employer stock as "ESOPs." ESOPs are employee benefit plans that invest primarily in employer stock. Eligible individual account plans ("EIAPs") include both ESOPs and 401(k) plans, the latter of which may offer ESOP and non-ESOP funds as investment options. *See* 29 U.S.C. § 1107(d)(3)(A)(ii) (defining EIAPs). Petitioner's 401(k) plan offers employees the option to invest in a variety of funds, including an ESOP.

ESOPs are incredibly popular among employers and employees alike because they allow employees to share in the ownership and long-term success of the company for which they work. Productivity, employee satisfaction, and profitability all tend to rise when employees own a stake in their employer.

Congress carefully crafted ERISA to ensure that employers are permitted and encouraged to offer ESOPs. In *Dudenhoeffer*, this Court recognized that "meritless, economically burdensome lawsuits" threaten to defeat Congress's desire "to encourage the creation of ESOPs." 573 U.S. at 424–25. To weed out meritless lawsuits, this Court set forth a demanding pleading standard for claims against ESOP fiduciaries. When a plaintiff alleges that an insider fiduciary should have acted on non-public information to prevent plan participants from investing in an ESOP, he must allege "that a prudent fiduciary in the defendant's position *could not* have concluded that stopping purchases . . . or publicly disclosing negative information would do more harm than good to the fund by causing a drop in the stock price . . . ." *Id.* at 429–30 (emphasis added). The Court confirmed that demanding pleading standard in *Amgen Inc. v. Harris*, 136 S. Ct. 758 (2016). Since *Amgen*, every court to apply the *Dudenhoeffer* standard had dismissed claims challenging the prudence of maintaining an ESOP as an investment option.

The court below, however, relaxed the pleading standard and held that generalized allegations are sufficient to state a claim under *Dudenhoeffer*. In so holding, the decision below neutralizes the

Dudenhoeffer standard in the Second Circuit. If left to stand, the decision will deter companies from offering ESOPs because ESOP fiduciaries will be vulnerable to claims that they breached their duty of prudence whenever the company's stock price declines. The Court should grant the petition to confirm that the *Dudenhoeffer* pleading standard requires more than generalized allegations to state a claim against an ESOP fiduciary.

ARGUMENT

I. ESOPs Offer Unique Benefits to Employers and Employees.

ESOPs are fundamentally different from other types of investment funds offered in conjunction with 401(k) and other employee retirement plans. By definition, ESOPs invest primarily in a single stock, whereas the typical investment fund is diversified and tailored to a particular risk profile. *See Dudenhoeffer*, 573 U.S. at 416. Consistent with their structure and composition, ESOPs also serve different purposes. Whereas typical investment funds are offered and maintained solely to increase or preserve a participant's retirement savings, ESOPs are additionally designed to provide employees with the opportunity to participate in the ownership of their employers. *See Saumer v. Cliffs Nat. Res. Inc.*, 853 F.3d 855, 866 (6th Cir. 2017) (explaining that Congress saw ESOPs as a way "of bringing about stock ownership by all corporate employees" (internal quotation marks omitted)).

ESOPs are beneficial to employers because they provide an affordable means of raising capital. *See*

119 Cong. Rec. 22,550 (Dec. 11, 1973) (statement of Sen. Russell Long, Chair of Senate Finance Committee when ERISA was enacted) (employee ownership plans "provide low-cost capital for the employer"). Moreover, employers that offer their employees the opportunity to own company stock tend to experience increases in productivity, sales, and hiring. *See* Steven F. Freeman, *Effects of ESOP Adoption and Employee Ownership: Thirty Years of Research and Experience*, 11–13, 23 (Univ. of Penn. Organizational Dynamics Working Papers, Paper No. 07-01, 2007) http://repository.upenn.edu/od_working_papers/2/ ("on average[,] in all the performance categories, ESOP companies do better per year than non-ESOP companies").

At the same time, ESOPs offer unique benefits to employees. *See id.* at 6–10 (summarizing the benefits enjoyed by ESOP participants and concluding that the "[r]esearch suggests almost entirely positive effects for individuals of ESOP adoption and, more generally, employee ownership"). Among other things, employees who own company stock report feeling more committed to their employer, and studies have shown that they are more satisfied with their work. *Enron and Beyond: Enhancing Worker Retirement Security: Hearing Before the H. Subcomm. on Employer-Employee Relations*, 107th Cong. 107-44 (Feb. 13, 2002) (statement of Douglas Kruse, Professor, Rutgers Univ.). And, of course, ESOPs offer employees the opportunity to share financially in the success of their employer.

For all of these reasons, ESOPs are popular among employers and employees alike. Since their introduction in the 1970s, ESOPs have become widely available on the menu of investment options under self-directed ERISA retirement plans, and voluntary participation by employees is high. It is estimated that nearly 10,000 U.S. companies offer some form of an ESOP, with more than 15 million workers choosing to participate. *See A Statistical Profile of Employee Ownership*, NCEO, http://www.nceo.org/articles/statistical-profile-employee-ownership (last visited Apr. 1, 2019).

II. ESOPs Are Favored by Congress.

Congress has recognized the many benefits of ESOPs and has encouraged employers to sponsor them:

> Intent of Congress Concerning Employee Stock Ownership Plans—The Congress, in a series of laws . . . has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees.

Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1520 (1976).

Consistent with its favorable view of ESOPs, Congress has carved out certain exceptions to ERISA's requirements to encourage employers to offer their employees the opportunity to invest in company stock. For example, Congress has exempted ESOPs from ERISA's diversification requirements—which would normally limit the percentage of a plan's assets that could be invested in any single security—as well as from prohibited transaction rules that would similarly limit plan ownership of employer stock. *See* 29 U.S.C. § 1104(a)(2) (providing that in the case of an EIAP, the diversification requirement and the prudence requirement (insofar as it requires diversification) are not violated by the acquisition or holding of employer stock); *id.* § 1107(b)(1) (exempting EIAPs from the rule that employer stock cannot compose more than 10% of an ERISA plan's total value).

Congress also has enacted numerous other laws to incentivize employers to offer ESOPs. *See* Cong. Res. Serv., RS 21526, *Employee Stock Ownership Plans (ESOPs) Legislative History* (May 20, 2003), https://www.everycrsreport.com/reports/RS21526.html (last visited Apr. 1, 2019). For example, Congress provides significant tax advantages to companies that offer ESOPs to their employees. A company may deduct certain contributions that it makes to an ESOP, *see* 26 U.S.C. § 404(a)(9), as well as certain dividends paid to fund participants, *see id.* § 404(k). Moreover, owners of closely held corporations can defer taxation on capital gains from certain stock sold to an ESOP. *See id.* § 1042.

Congress further created incentives for employees to participate in ESOPs. For instance, the Internal Revenue Code provides special benefits to employees, such as deferred tax on "net unrealized appreciation," *id.* § 402(e)(4), and an exception from the penalty for early distributions for employer stock dividends, *see id.* § 72(t)(2)(A)(vi).

Accordingly, ESOPs are plainly favored by Congress in light of the many economic and social benefits that arise from employee ownership. Indeed, Congress has warned the courts and administrative agencies against issuing "regulations and rulings which treat employee stock ownership plans as conventional retirement plans," lest they be regulated out of existence. Tax Reform Act § 803(h).

III. Courts Have Historically Protected Employers Who Offer ESOPs.

Companies offering ESOPs are particularly susceptible to strike suits because when the company stock price inevitably drops, plaintiffs can always allege in hindsight that plan fiduciaries should have known that company stock was an imprudent investment and taken steps to prevent participants from investing in it. Such strike suits are particularly common when the plan fiduciary is a company insider. Courts therefore have developed doctrines to protect companies and insider ESOP fiduciaries from meritless imprudence claims.

In *Moench v. Robertson*, the Third Circuit considered the purpose of ESOPs and Congress's intent to incentivize companies to offer such funds, noting the tension that is created by promoting

employee ownership of company stock on the one hand, and ERISA's stringent fiduciary standards and goal of protecting financial security upon retirement on the other hand. 62 F.3d 553, 568–72 (3d Cir. 1995), *abrogated in part by Dudenhoeffer*, 573 U.S. at 417. To balance these competing interests, the Third Circuit developed a presumption that, absent a showing of dire circumstances, insider fiduciaries act prudently when they allow employees to invest in an ESOP. *Id.* at 571–72.

For nearly two decades, many other Circuits adopted some form of the *Moench* presumption to dismiss baseless claims against ESOP fiduciaries. *See, e.g.*, *White v. Marshall & Ilsley Corp.*, 714 F.3d 980, 994 (7th Cir. 2013); *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1282 (11th Cir. 2012); *In re Citigroup ERISA Litig.*, 662 F.3d 128, 140 (2d Cir. 2011); *Quan v. Comput. Scis. Corp.*, 623 F.3d 870, 882 (9th Cir. 2010); *Edgar v. Avaya, Inc.*, 503 F.3d 340, 348–49 (3d Cir. 2007); *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 255 (5th Cir. 2008).[3] The widespread adoption of the *Moench* presumption made it difficult for plaintiffs to survive a motion to dismiss with a baseless stock-drop claim, and the number of lawsuits challenging the prudence of offering an ESOP declined sharply. *See* Kivanç Kirgiz, *Trends in ERISA Stock Drop Litigation* (Aug. 20, 2012), https://www.cornerstone.com/Publications/Articles/Trends-in-ERISA-Stock-Drop-Litigation.

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[3] All of these cases were abrogated by *Dudenhoeffer* as explained below.

In *Dudenhoeffer*, this Court declined to endorse the *Moench* presumption because it had no footing in the text of ERISA. 573 U.S. at 419. The Court nevertheless recognized the concerns that informed the development of the presumption in the first place—namely, the need to protect plan fiduciaries offering ESOPs from lawsuits asserting meritless imprudence claims. *Id.* at 424–25; *see also Amgen*, 136 S. Ct. at 759. The Court observed that such fiduciaries find themselves between a "rock and a hard place": If they keep an ESOP in a plan, they can be sued for imprudence if the stock price goes down, but if they remove the ESOP and the stock price goes up, they can be sued for disobeying the plan document. *Dudenhoeffer*, 573 U.S. at 424.

To guard against these concerns, the Court adopted a demanding pleading standard for claims against ESOP fiduciaries. For claims, like the one below, alleging that an insider fiduciary breached a duty by failing to act on non-public information to prevent losses in an allegedly overvalued ESOP, *Dudenhoeffer* held that the "plaintiff must plausibly allege an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." *Id.* at 428. *Dudenhoeffer* alternatively expressed the standard as requiring a plaintiff to plead an alternative action that a prudent fiduciary "could not" view as doing more harm than good—as opposed to "would not" view. *Id* at 429–30.

The Court stressed that this is a fact-sensitive legal standard, not a categorical one. "Because the content of the duty of prudence turns on 'the circumstances . . . prevailing' at the time the fiduciary acts," the Court reasoned, "the appropriate inquiry will necessarily be context specific." *Id.* at 425 (quoting 29 U.S.C. § 1104(a)(1)(B)). The Court thus held that the appropriate inquiry demands "careful, context-sensitive scrutiny of a complaint's allegations," and "requires careful judicial consideration of whether the complaint states a claim that the defendant has acted imprudently." *Id.* Only through such careful consideration of the facts, the Court explained, can "the motion to dismiss for failure to state a claim" fulfill its role as an "important mechanism for weeding out meritless claims" against ESOP fiduciaries. *Id.*

Two years later, the Court removed any doubts about the need to apply the *Dudenhoeffer* standard rigorously at the pleadings stage. In *Amgen*, the Court summarily reversed a Ninth Circuit decision permitting an imprudence claim to proceed because the lower court "failed to assess whether the complaint . . . plausibly alleged that a prudent fiduciary in the same position could not have concluded that the alternative action would do more harm than good." 136 S. Ct. at 760 (internal quotation marks omitted).

Accordingly, when the Court jettisoned the *Moench* presumption, it replaced it with *Dudenhoeffer*'s stringent pleading standard, which is likewise designed to protect ESOP fiduciaries from meritless suits at the early stages of litigation. *See*

Amgen, 136 S. Ct. at 759. The Circuits have recognized that the *Dudenhoeffer* standard is deliberately difficult to satisfy and "raised the bar for plaintiffs seeking to bring a claim based on a breach of the duty of prudence." *Saumer*, 853 F.3d at 861; *see Graham v. Fearon*, 721 F. App'x 429, 438 (6th Cir. 2018) (recognizing that the *Dudenhoeffer* standard is "difficult for plaintiffs to meet"); *Whitley v. BP, P.L.C.*, 838 F.3d 523, 528–29 (5th Cir. 2016) (describing *Dudenhoeffer* pleading burden as "significant").

IV. The Decision Below Ignores the Teachings of *Dudenhoeffer* and Creates a Circuit Split.

In the years since *Amgen*, every court, other than the court below, to consider a claim alleging that an insider fiduciary should have acted on inside information to prevent participants from investing in an ESOP has dismissed the claim as inadequately pled. *Graham*, 721 F. App'x at 438. These courts have recognized that an imprudence claim is implausible if it is supported only by generalized allegations that an insider fiduciary had inside information about the employer's stock price that he should have acted upon. *See, e.g., id.*; *Martone v. Robb*, 902 F.3d 519, 523 (5th Cir. 2018); *Singh v. RadioShack Corp.*, 882 F.3d 137, 149 (5th Cir. 2018); *Laffen v. Hewlett-Packard Co.*, 721 F. App'x 642, 644 (9th Cir. 2018); *Saumer*, 853 F.3d at 861; *Whitley* 838 F.3d at 529.

The decision below cannot be reconciled with *Dudenhoeffer* or its progeny because it holds that generalized allegations are sufficient to make out an

imprudence claim. The linchpin of the decision below is an allegation that it is always better for ESOP participants if a fiduciary discloses negative inside information sooner rather than later. Appendix to the Petition 15a. But as the petition explains, that same generic allegation can be made in every case alleging that ESOP fiduciaries violated their duty of prudence. Pet. 11–17. Indeed, that same allegation has been made in many other cases and has universally been held to be insufficient. *See Martone*, 902 F.3d at 526–27 (rejecting allegation that earlier disclosure would have been better because the longer an ongoing fraud persisted, the harsher the correction would be); *Laffen*, 721 F. App'x at 644 (holding that earlier disclosure could have caused more harm than good); *Graham*, 721 F. App'x at 437 ("Although earlier disclosure may have ameliorated some harm to the Fund, that course of action was not so clearly beneficial that a prudent fiduciary could not conclude that it would be more likely to harm the fund than to help it."); *Saumer*, 853 F.3d at 864 (holding that a prudent fiduciary could have concluded that earlier disclosure would have collapsed the company stock price); *Whitley*, 838 F.3d at 529 (holding that a prudent fiduciary "could very easily conclude" that earlier disclosure would have done more harm than good).

Unlike the court below, every other court to consider a stock-drop claim after *Amgen* has heeded this Court's direction to engage in "careful, context-sensitive scrutiny of a complaint's allegations" to protect ESOP fiduciaries from meritless lawsuits. *Dudenhoeffer*, 573 U.S. at 425; *see, e.g.*, *Saumer*, 853 F.3d at 866 (recognizing that rigorous application of

Dudenhoeffer is necessary to comply with Congress's desire to protect ESOPs). The decision below not only conflicts with the decisions of those courts but also weakens the *Dudenhoeffer* pleading standard in the Second Circuit, which will have deleterious consequences for companies that offer ESOPs.

V. If the Decision Below Stands, Plan Sponsors Will Be Discouraged from Offering ESOPs, Harming Participants and Sponsors Alike.

If the decision below stands, employers will be discouraged from offering ESOPs in the first instance for fear of being forced into high-dollar settlements or incurring significant legal fees to defend imprudence claims. A reduction in the availability of ESOPs would in turn eliminate the benefits that these funds engender, frustrate congressional purpose, and imperil retirement security.

Beginning in the late 1990s, with pronounced surges after the collapse of Enron and the 2007–2008 financial crisis, fiduciaries of ERISA plans offering ESOPs have faced an onslaught of stock-drop lawsuits. *See* ERISA Company Stock Cases, Cornerstone Res., https://www.cornerstone.com/Publications/Research/ERISA-Company-Stock-Cases (last visited Apr. 1, 2019) (noting over 250 stock-drop cases filed between 1997 and 2014). *Dudenhoeffer* and *Amgen* have largely succeeded at nipping meritless claims in the bud by ensuring their dismissal at the pleading stage. By holding that generalized allegations can satisfy the *Dudenhoeffer* pleading standard, however, the decision below makes it likely that more of these meritless cases

will survive a motion to dismiss and proceed to discovery.

With the door to discovery re-opened, nothing will prevent a plaintiff with a groundless claim from "tak[ing] up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value," *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 546 (2007), and the plaintiffs' bar will rush to file nuisance suits every time the stock price of a company offering an ESOP drops. Because prudence claims are fact-intensive, discovery in these cases is especially costly and burdensome. *See, e.g.*, *Pension Ben. Guar. Corp. v. Morgan Stanley Inv. Mgmt. Inc.*, 712 F.3d 705, 719 (2d Cir. 2013) (stating 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 about its methods and knowledge at the relevant times"). Consequently, when such claims do survive a motion to dismiss, fiduciaries are often pressured into settling claims for large sums of money. *See Twombly*, 550 U.S. at 558 (recognizing that the expense and inconvenience of discovery often compel a defendant to settle even an unmeritorious suit). According to one study, settlement values for ERISA company stock-drop cases for which data is available average $31.4 million, with a median settlement amount of $6.5 million. ERISA Company Stock Cases, Cornerstone Res., https://www.cornerstone.com/Publications/Research/ERISA-Company-Stock-Cases (last visited Apr. 1, 2019).

The rush to court will be even more pronounced because the decision below was rendered in the Second Circuit, where many employers are amenable to suit. *See id.* (observing that half of all stock-drop cases were filed in the Second Circuit and two other Circuits and that the Southern District of New York is one of the two districts with the most stock-drop suits). With a new, relaxed pleading standard in the Second Circuit, plaintiffs will have the incentive to forum-shop and file their claims in New York rather than in other venues where the standard is appropriately strict. The risk of forum-shopping is exacerbated by ERISA's liberal venue provision, which allows plaintiffs to bring suit where any defendant "may be found," not just "where the plan is administered, where the breach took place, or where a defendant resides." 29 U.S.C. § 1132(e)(2).

The result would be the discouraging of ESOPs, which, as discussed above, is precisely what Congress warned against when it first crafted the special standards governing ESOPs:

> Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of . . . employers to take the necessary steps to implement the plans, and which otherwise block the establishments and success of these plans.

Tax Reform Act, § 803(h). That is what this Court sought to avoid when crafting *Dudenhoeffer*'s stringent pleading standard, which was specifically designed to weed out meritless ESOP stock-drop claims based on generalized allegations. *Dudenhoeffer*, 573 U.S. at 425. To protect these important plans, the employers who sponsor them, the fiduciaries who administer them, and the employees who participate in them, this Court should grant the petition to resolve the Circuit split, prevent forum shopping, and stem the tide of meritless imprudence claims that the decision below will unleash.

CONCLUSION

The petition for certiorari should be granted.

April 8, 2019

Respectfully submitted,

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