
LEGAL UPDATE

Supreme Court's *Amgen* Decision Clarifies Treatment of Inside Information in Stock Drop Cases

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4 01(k) plan investment menus frequently include an employer stock fund in which plan participants can invest their elective deferrals as well as employer contributions. These plans have been subject to class action

lawsuits triggered by a drop in the stock's value alleging that plan fiduciaries breached their duties under ERISA by allowing the plan to hold or make new investments in the stock.

Until the U.S. Supreme Court's 2014 *Dudenhoeffer* decision, fiduciaries were generally protected by a presumption of prudence, known as the "Moench" presumption from the appellate decision in which the presumption was first applied. In *Dudenhoeffer*, the Supreme Court decided there was no basis for the presumption which, on its face, was a positive development for the plaintiffs' bar.

Claims Based on Public Information. *Dudenhoeffer* replaced the presumption of prudence with directions to the lower courts on how they should evaluate stock drop claims to distinguish those with potential merit and those that should be dismissed. Where the claim was based on publicly available information and the stock traded publicly, the Court held that, "allegations that a fiduciary should have recognized from publicly available information alone that the market was over or undervaluing the stock are implausible as a general rule, at least in the absence of special circumstances." It was predicted that this deference to the market would make it very difficult to mount stock drop cases based on public information regarding the employer's deteriorating condition.

Insider Information Claim Against Amgen. The *Dudenhoeffer* decision also provided guidance for claims based on nonpublic information, but it appears that it was not carefully read by the bar or the courts. Thus, the Supreme Court recently reinforced its views in *Amgen v. Harris*, a stock drop case involving an ESOP where the plan participants alleged that their employer, a pharmaceutical firm, suppressed information from clinical trials and studies about the safety of an anemia drug and that, knowing this, plan fiduciaries improperly retained company stock as a plan investment. The value of the plan's company stock investment inevitably declined when these drug safety issues became public.

The *Amgen* case first reached the Supreme Court shortly after *Dudenhoeffer*. The district court dismissed the complaint, but the Ninth Circuit Court of Appeals reversed and allowed the case to go forward. The Supreme Court, in turn, reversed the Ninth Circuit and sent the case back to be decided in light of *Dudenhoeffer*. On remand, the Ninth Circuit asserted that its original decision anticipated *Dudenhoeffer* and it, therefore, reinstated the complaint against *Amgen*, because "it is at least plausible that defendants, [*i.e.*, the plan fiduciaries] could have removed the Amgen Stock Fund from the list of investment options available to the plans without causing undue harm to participants." The Ninth Circuit reasoned that it was not clear what effect this action would have had on the stock's price.

On the second and most recent trip of the *Amgen* case to the Supreme Court, the Supreme Court once again reversed the Ninth Circuit, ruling that the appeals court was only half right in its interpretation of *Dudenhoeffer*. The Ninth Circuit was on firm ground in holding that a plaintiff needs to allege

an alternative action (like removing company stock from the plan's investment menu) the defendant could have taken that would have been consistent with securities laws and that a prudent fiduciary would not have viewed as more likely to harm the company stock fund than to help it.

Dudenhoeffer Inside Information Standard Clarified. The Ninth Circuit, however, failed to ask another question required by *Dudenhoeffer*, specifically whether the complaint plausibly alleged that a prudent fiduciary "could not have concluded that stopping purchases—which the market might take as a sign that insider fiduciaries viewed the employer's stock as a bad investment—would do more harm than good." Moreover, the Supreme Court noted that the complaint cannot simply make a bald assertion that this is so, but must back it up with facts and allegations that will be at issue if the case ever comes to trial. In other words, a complaint must explain why standing pat would be unreasonable and should be scrutinized for facts, not just conclusory assertions. The Ninth Circuit thought it "quite plausible" that removal of the Amgen stock from the plan menu would have done no harm, but in light of the new Supreme Court decision, such an exercise of hindsight will not avoid dismissal if there are no supporting facts in the complaint.

The *Amgen* case has been remanded for further proceedings consistent with this new elaboration of *Dudenhoeffer*. Reading between the lines, the Supreme Court's impatience with the Ninth Circuit's reading of the complaint is evident, as is the suggestion that the district court has the primary responsibility for reviewing the complaint.

Impact on Future Stock Drop Claims. The additional standard of inquiry that *Amgen* clarifies must be applied in insider information cases should make it significantly harder to mount this type of stock drop case, but it remains to be seen whether the lower courts get the message. The first cases to be decided after *Dudenhoeffer* all involved assertions that company stock was a poor investment based on publicly available information. In the first of these cases, which involved the Kodak bankruptcy, a district court denied the defendant fiduciaries' motion to dismiss, because it viewed public information as a more accurate predictor of the company's slide into bankruptcy than the day-to-day fluctuations of the market. Subsequent decisions, however, have not been so resistant to the Supreme Court's emphasis on the market for establishing the value of company stock. Thus, lawsuits brought on the basis of events affecting the value of company stock, such as the Deepwater Horizon explosion's impact on BP, the effect of the subprime lending crisis on Citigroup, and the consequences of industry competition on Delta Airlines have all been dismissed, because they relied on public information that supposedly demonstrated the particular company's perilous condition.

When it comes to inside information about negative corporate developments, however, courts may have different opinions on the reasonableness of courses of action a fiduciary might have taken other than stopping future purchases of company stock or removing it from the plan investment menu. In particular, there appear to be differences of opinion with respect to whether such actions would be consistent with securities law. Accordingly, the last chapter may not have been written where stock drop cases are based on non-public information.

After *Dudenhoeffer*, it was sometimes recommended that plan sponsors consider excluding personnel with access

to inside information from serving on plan committees in order to remove fiduciaries' possession of this knowledge as the basis for a stock drop claim. This may still be a good idea, although post-*Amgen* experience may warrant reconsideration of this advice if experience shows that plaintiffs are unable to make the case that stopping employer stock purchases would not do more harm than good and is the only feasible way to protect the plan.

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