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.

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

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE SUPPORTING NEITHER PARTY

RACHEL MONDL
Deputy Solicitor of Labor
G. WILLIAM SCOTT
Associate Solicitor
THOMAS TSO
Counsel for Appellate and Special Litigation
EIRIK CHEVERUD
Trial Attorney
Department of Labor
Washington, D.C. 20210

ROBERT B. STEBBINS
General Counsel
MICHAEL A. CONLEY
Solicitor
DAVID D. LISITZA
Senior Litigation Counsel
Securities and Exchange Commission
Washington, D.C. 20549

NOEL J. FRANCISCO
Solicitor General
Counsel of Record
EDWIN S. KNEEDLER
Deputy Solicitor General
JONATHAN Y. ELLIS
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

QUESTION PRESENTED

Whether the "more harm than good" pleading consideration from *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U.S. 409, 430 (2014), can be satisfied by generalized allegations that the harm of an inevitable disclosure of an alleged fraud generally increases over time.

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INTEREST OF THE UNITED STATES

This case concerns the scope of fiduciary duties imposed on plan fiduciaries by the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829, and the relationship between those duties and the federal securities laws. The Secretary of Labor has primary authority for administering ERISA. The Department of Justice and the Securities and Exchange Commission (SEC) administer and enforce the federal securities laws. The United States therefore has a substantial interest in this Court's resolution of the question presented.

STATEMENT

1. a. ERISA is designed to "protect * * * the interests of participants in employee benefit plans and their beneficiaries * * * by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. 1001(b). The statute requires every plan to be established and maintained pursuant to a written instrument and to have named fiduciaries who have authority to control and manage the administration of the plan and its assets. 29 U.S.C. 1102(a)(1), 1103(a). A person is a fiduciary if "he exercises any discretionary authority or discretionary control respecting management of [an ERISA] plan * * * or control respecting management or disposition of its assets," if "he renders investment advice * * * with respect to any moneys or other property of such plan," or if "he has any discretionary authority or discretionary responsibility in the administration of such plan." 29 U.S.C. 1002(21)(A).

ERISA subjects plan fiduciaries to certain fiduciary duties derived from the common law of trusts. 29 U.S.C. 1104(a); see *Central States, Se. & Sw. Areas Pension Fund* v. *Central Transport, Inc.*, 472 U.S. 559, 570 (1985). A fiduciary must "discharge his duties with respect to a plan solely in the interest of [its] participants and beneficiaries," and "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." 29 U.S.C. 1104(a)(1)(B). Plan participants and their beneficiaries

may seek judicial redress against a fiduciary for violations of the plan or the statute, including breaches of ERISA's fiduciary duties. 29 U.S.C. 1132(a)(2) and (3); *Varity Corp.* v. *Howe*, 516 U.S. 489, 507-515 (1996).

b. This case concerns the application of ERISA's fiduciary duties to individuals who administer an employee stock ownership plan (ESOP), a type of "individual account plan." 29 U.S.C. 1107(d)(3)(A)(ii). An individual account plan is "a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses." 29 U.S.C. 1002(34). Such plans often give each participant the discretion to select from a range of investment options chosen by the plan fiduciaries. An ESOP is an individual account plan that "is designed to invest primarily in qualifying employer securities" and meets certain other requirements. 29 U.S.C. 1107(d)(6)(A). An employer's common stock is one type of "qualifying employer security." 29 U.S.C. 1107(d)(5).

ERISA's duty of prudence ordinarily requires ERISA fiduciaries to "diversify 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." 29 U.S.C. 1104(a)(1)(C). Because ESOPs "'invest primarily in' the stock of the participants' employer," *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U.S. 409, 416 (2014) (citation omitted), they are by definition "*not* prudently diversified." *Ibid.* Congress thus made clear that ESOP fiduciaries do not violate the diversification requirement of Section 1104(a)(1)(C) or the prudence requirement of Section 1104(a)(1)(B), "to the extent that it requires diversification," by acquiring or holding "qualifying employer securities"—*e.g.*, common stock of

the participants' employer. 29 U.S.C. 1104(a)(2). As a result, ESOP fiduciaries "are not liable for losses that result from a failure to diversify." *Dudenhoeffer*, 573 U.S. at 419. "But aside from that distinction, * * * ESOP fiduciaries are subject to the duty of prudence just as other ERISA fiduciaries are." *Ibid.*

c. The Court described how these principles operate in the context of ESOPs holding publicly traded stock to a certain extent in *Dudenhoeffer*, *supra*, and *Amgen Inc.* v. *Harris*, 136 S. Ct. 758 (2016) (per curiam).

In *Dudenhoeffer*, although declining to adopt a "presumption of prudence" for ESOP fiduciaries "when their decisions to hold or buy employer stock are challenged as imprudent," the Court acknowledged the "legitimate" concerns that had led some lower courts to adopt such a presumption. 573 U.S. at 417, 423. The Court recognized the potential for conflict between the duty of prudence and the federal securities laws, observing that "ESOP fiduciaries often are company insiders" who are alleged to have acted imprudently by "failing to act on inside information they had about the value of the employer's stock," despite the prohibition on insider trading. *Ibid.* The Court also acknowledged that meritless ERISA suits can place an ESOP fiduciary "between a rock and a hard place: If he keeps investing and the stock goes down he may be sued for acting imprudently * * * , but if he stops investing and the stock goes up he may be sued for disobeying the plan documents." *Id.* at 424.

The Court reasoned that such concerns were better addressed "through careful, context-sensitive scrutiny of a complaint's allegations" to "divide the plausible sheep from the meritless goats." *Dudenhoeffer*, 573 U.S. at 425. The Court instructed lower courts to

subject duty-of-prudence claims to "careful judicial consideration," *ibid.*, in determining whether a complaint's allegations meet the pleading standard described in *Ashcroft* v. *Iqbal*, 556 U.S. 662 (2009), and *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544 (2007). Under that standard, the Court stated that "[t]o state a claim for breach of the duty of prudence on the basis of inside information, a 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." *Dudenhoeffer*, 573 U.S. at 428.

The Court then identified three considerations that should "inform" a district court's consideration of whether a plaintiff has satisfied that standard. *Dudenhoeffer*, 573 U.S. at 428. First, the Court stated that lower courts "must bear in mind" that "ERISA's duty of prudence cannot require an ESOP fiduciary to perform an action * * * that would violate the securities laws." *Ibid.* Second, the Court instructed that, where an ESOP fiduciary is faulted for failing to act "on the basis of the inside information," lower courts must consider whether an "ERISA-based obligation either to refrain on the basis of inside information from making a planned trade or to disclose inside information to the public could conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws." *Id.* at 429. Third, the Court explained that lower courts must consider "whether the complaint has plausibly alleged 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 and a concomitant drop in the value of the stock already held by the fund." *Id.* at 429-430.

In *Amgen*, the Court repeated its concern for the "potential for conflict" between an ESOP fiduciary's ERISA obligations and the federal securities laws. 136 S. Ct. at 759. It also reiterated a district court's obligation to apply the considerations from *Dudenhoeffer* whenever an ESOP fiduciary is alleged to have breached his duty of prudence based on his response to "inside information." *Ibid.*

2. International Business Machines Corporation (IBM) sponsors an individual account retirement plan for its employees called the IBM 401(k) Plus Plan (Plan). Second Amended Complaint (SAC) ¶¶ 10, 45. Among the investment options for Plan participants is the IBM Company Stock Fund (Fund)—an ESOP that primarily invests in publicly traded IBM common stock. SAC 1. Respondents are Plan participants who bought and held Fund shares during the class period of January 21, 2014, through October 20, 2014. SAC 1, ¶¶ 38-39, 141. Petitioners are the Retirement Plans Committee of IBM and several individuals who served as ERISA fiduciaries to the Plan during that time. SAC ¶¶ 40-43. The individual petitioners were also high-level executives at IBM. SAC ¶¶ 41-43.

The complaint in this case is based on petitioners' administration of the Fund leading up to IBM's divestiture of its Microelectronics business in October 2014. The Microelectronics business was a division of IBM's Systems and Technology Segment (STG) that designed and produced microchips. SAC ¶ 55. During most of relevant period, the Microelectronics business was reflected on IBM's balance sheets as carrying a value of

$2.4 billion. SAC ¶¶ 11, 78. Microelectronics, however, lost more than $600 million per year: $638 million in 2012, $720 million in 2013, and $619 million in the first three quarters of 2014. SAC ¶ 78.

In early 2013, IBM began looking for a buyer for its Microelectronics business. SAC ¶ 59. Although IBM continued to value the business at over $2 billion, it was unable to find a buyer willing to pay that amount. SAC ¶ 60. Eventually, on October 20, 2014, IBM announced that it had reached an agreement with chipmaker GlobalFoundries. SAC ¶ 80. Under the agreement, IBM paid GlobalFoundries $1.5 billion to acquire the Microelectronics business and to continue supplying semiconductors to IBM. *Ibid.* At the same time, IBM announced a complete $2.4 billion write-down of Microelectronics' carrying value and $800 million in estimated costs of the agreement. SAC ¶¶ 81, 92. By the end of the announcement day, IBM's stock price had declined more than $12.00 per share and lost more than 7% of its value. SAC ¶¶ 91, 129.

3. Following these events, two suits were filed in the Southern District of New York on behalf of certain IBM shareholders.

a. In *International Ass'n of Heat & Frost Insulators* v. *IBM Corp.*, 205 F. Supp. 3d 527 (S.D.N.Y. 2016) (*Insulators*), a group of investors in IBM common stock filed a securities class action on behalf of all such investors between January 22, 2014, and October 17, 2014, against IBM and several individual IBM executives, including petitioner Martin Schroeter. *Id.* at 530. These plaintiffs alleged that IBM and the executives had violated Section 10(b) of the Securities Exchange Act of 1934, ch. 404, § 10(b), 48 Stat. 891 (Exchange Act), and Rule 10(b)(5), 17 C.F.R. 240.10b-5, by, among other

things, failing to report that the Microelectronics business was materially impaired prior to the October 20, 2014 announcement of its sale, and by representing that IBM's financial statements had been prepared in accordance with Generally Accepted Accounting Principles (GAAP) despite that failure. *Insulators*, 205 F. Supp. 3d at 532. According to the plaintiffs, under the relevant GAAP standards,[1] Microelectronics' losses in 2012, 2013, and 2014 should have triggered impairment testing for the business. *Id.* at 534-535. They alleged that such testing would have led to a write-down of the business prior to the third quarter of 2014. *Id.* at 534.

b. In this case, respondents rely on the same alleged accounting errors to assert a claim under ERISA, rather than the securities laws. According to respondents, IBM's failure to recognize the impairment of the Microelectronics business led it to "grossly overstate[] the value" of the business in its 2013 and 2014 financial reporting. SAC ¶ 9. Respondents allege that IBM's failure to disclose such "critical, material information to the public[] caused the market to improperly value IBM's stock," and that, by virtue of their high-level positions in the company, petitioners knew or should have known that IBM's stock was "artificially inflated * * * throughout the Class Period." *Ibid.*; see SAC ¶ 19.

Respondents contend that petitioners violated ERISA's duty of prudence when they failed to take action to prevent the Fund from making additional purchases of IBM stock at inflated prices during the class period. SAC ¶ 20. As relevant here, to prevent that ongoing harm to Plan participants, respondents allege

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[1] Under GAAP, a long-lived asset is impaired if the carrying amount of the asset is not recoverable and exceeds its fair value. Accounting Standards Codification (ASC) 360-10-35-17.

that petitioners could have "issued truthful or corrective disclosures to cure the fraud," and that petitioners could not have reasonably believed that taking such action would do "more harm than good" to the Plan. SAC ¶¶ 21, 25. They allege that an earlier disclosure would have "ended the artificial inflation in IBM's stock price" and mitigated the long-term reputational damage that IBM would suffer when the truth came to light. SAC ¶ 105; see SAC ¶¶ 104-119.

4. The *Insulators* case and this case were assigned to the same district judge, who dismissed both complaints. Pet. App. 25a-44a (dismissing the SAC); *Jander* v. *IBM Corp.*, 205 F. Supp. 3d 538 (S.D.N.Y. 2016) (dismissing previous complaint); *Insulators*, *supra* (dismissing complaint).

a. In *Insulators*, the district court held that the plaintiffs had plausibly alleged that Microelectronics' losses required impairment testing of the business before October 20, 2014, but that the complaint failed to adequately plead the scienter required to state a private claim under the federal securities laws. 205 F. Supp. 3d at 534, 535-537. The court explained that whether impairment testing was required turned on whether the Microelectronics business was properly treated under GAAP as an independent "asset group" or, as the defendants urged, an integrated part of IBM's larger STG segment. *Id.* at 532. And the court concluded that, "while IBM raise[d] strong arguments that Microeletronics was so vertically integrated into [the larger STG segment] that it could not be classified as a standalone asset group," the complaint sufficiently alleged to the contrary at that stage of the litigation. *Id.* at 533. The court further held, however, that the plaintiffs failed to adequately allege, with the specificity required

by the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737, that the defendants acted with scienter in representing that IBM's financial statements had been prepared in accordance with GAAP. *Insulators*, 205 F. Supp. 3d at 535-537.

No party appealed the *Insulators* decision.

b. In this case, the district court held that respondents also adequately alleged that the Microelectronics business was impaired prior to October 20, 2014, and that petitioners were aware of that impairment. *Jander*, 205 F. Supp. 3d at 542. The court nevertheless dismissed the complaint on the ground that respondents failed to adequately plead that petitioners could not have concluded that an earlier disclosure was "more likely to harm the fund than to help it." Pet. App. 31a (quoting *Dudenhoeffer*, 573 U.S. at 428). The court rejected respondents' concerns about the potential for additional reputational harm caused by a delay in disclosure, noting that such general allegations "fail[ed] to shed any light" on whether a prudent fiduciary under the particular circumstances of this case could have concluded that an earlier disclosure would do more harm than good. *Id.* at 33a.

5. The court of appeals reversed. Pet. App. 1a-24a. The court listed five allegations that it believed would support a determination that no prudent fiduciary could have concluded that an earlier disclosure would have done more harm than good: (1) petitioners "knew that IBM stock was artificially inflated through accounting violations," *id.* at 15a; (2) petitioners were "uniquely situated" to disclose the truth and correct the artificial inflation through IBM's ordinary SEC filings, *id.* at 16a (citation omitted); (3) the eventual disclosure of a pro-

longed fraud causes "'reputational damage' that 'increases the longer the fraud goes on[],'" *ibid.* (citation omitted; brackets in original); (4) "'IBM stock traded in an efficient market,'" and thus a prudent fiduciary need not fear "an irrational overreaction to the disclosure of fraud," *id.* at 18a-19a (citation omitted); and (5) petitioners "knew that disclosure of the truth * * * was inevitable, because IBM was likely to sell the business and would be unable to hide its overvaluation from the public at that point," *id.* at 19a.

SUMMARY OF ARGUMENT

Absent extraordinary circumstances, ERISA's duty of prudence requires an ESOP fiduciary to publicly disclose inside information only when the securities laws require such a disclosure.

A. In *Dudenhoeffer*, the Court identified three considerations that should inform whether an ERISA plaintiff has plausibly stated a duty-of-prudence claim against an ESOP fiduciary for failing to disclose inside information about the employer's stock. Although the parties largely focus on the third consideration—whether a prudent fiduciary could not have concluded that disclosure would do more harm than good—the proper analysis should be informed by the requirements and objectives of the securities laws. The federal securities laws provide a comprehensive scheme of public disclosure rules designed to protect investors. There is no sound reason to adopt a different set of disclosure rules to protect those investors who are participants in an ESOP. A prudent fiduciary therefore could not conclude that complying with a securities-laws-based duty to disclose would do more harm than good. But by the same token, in all but extraordinary circumstances, a

prudent fiduciary could conclude that disclosing confidential information when disclosure is not required by the securities laws would do more harm than good.

B. The courts below and the parties appear to expect a fiduciary to make an ad hoc prediction about whether a public disclosure would do more harm than good in a particular case. But ESOPs have multiple participants and beneficiaries who, at any given time, are likely to have competing economic interests. Both the direction and the strength of those interests in a public disclosure would turn on information about the future that, in many cases, neither the participant nor a fiduciary would know with reasonable certainty. An ad hoc cost-benefit analysis is therefore too indeterminate to serve the meaningful filtering role the Court contemplated. The better course is to recognize that Congress and the SEC have already made a judgment about when a public disclosure would do more harm than good, and prudent fiduciaries should generally not second-guess that judgment.

Petitioners alternatively contend that an ESOP fiduciary never has an ERISA-based duty to disclose information that is obtained in a corporate capacity. But that contention is squarely inconsistent with *Dudenhoeffer*. Petitioners also worry that imposing an ERISA-based duty to disclose would permit an end-run around the PSLRA. But district courts must subject duty-of-prudence claims to careful scrutiny to determine whether requiring a public disclosure would have conflicted with the objective of the securities laws.

C. Because the courts below did not apply the correct legal standard, this Court should vacate the judgment below and remand the case for further consideration.

ARGUMENT

ABSENT EXTRAORDINARY CIRCUMSTANCES, ERISA'S DUTY OF PRUDENCE REQUIRES AN ESOP FIDUCIARY TO PUBLICLY DISCLOSE INSIDE INFORMATION ONLY WHEN THE SECURITIES LAWS REQUIRE SUCH A DISCLOSURE

This case concerns when an ESOP fiduciary who is also a corporate official of the employer is required by ERISA's duty of prudence to publicly disclose material, nonpublic information about the employer. The federal securities laws already impose a comprehensive disclosure regime governing when, how, and by whom such disclosures must be made when the stock is publicly traded. But the courts below largely ignored that regime, focusing instead on an ad hoc analysis about when an ESOP fiduciary could conclude that public disclosure would do "more harm than good" in the particular case. The government respectfully suggests that is the wrong approach.

The disclosure regime of the federal securities laws is designed for the "protection of the investing public and the national economy." *Bateman Eichler, Hill Richards, Inc.* v. *Berner*, 472 U.S. 299, 315 (1985). Those objectives are served both by the disclosure obligations the securities laws impose and by the discretion they preserve for corporate management when they do not require disclosure. Courts should be reluctant to impose ERISA-based duties to publicly disclose confidential corporate information that exceed those imposed by the federal securities laws, and a prudent ESOP fiduciary generally should be able to rely on the judgment of Congress and the SEC about when such disclosures are required. Absent extraordinary circumstances, an ESOP

fiduciary has an ERISA-based duty to publicly disclose material, nonpublic information when, and only when, he has a securities-laws-based obligation to do so. Because the court of appeals did not consider whether the defendants were individually subject to such a duty, its judgment should be vacated and the case remanded for further consideration.

A. ERISA's Duty Of Prudence To Disclose Material Nonpublic Information Should Be Informed By *Dudenhoeffer* And Its Emphasis On The Requirements And Objectives Of The Securities Laws

ERISA imposes a duty of prudence on all plan fiduciaries. The statute provides that 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 * * * providing benefits to participants and their beneficiaries * * * ; [and] (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." 29 U.S.C. 1104(a)(1)(B). Those standards govern "fiduciaries' investment decisions and disposition of assets." *Fifth Third Bancorp* v. *Dudenhoeffer*, 573 U.S. 409, 419 (2014) (citation omitted).

In *Dudenhoeffer*, the Court explained that "[t]o state a claim for breach of the duty of prudence on the basis of inside information, a 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." 573 U.S. at 428. The

Court identified three considerations that should "inform" a district court's consideration of whether a plaintiff has satisfied that standard: (1) whether the alternative action would "require an ESOP fiduciary to * * * violate the securities laws"; (2) whether an "ERISA-based obligation" to take the action "could conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws"; and (3) "whether the complaint has plausibly alleged that a prudent fiduciary in the defendant's position could not have concluded that" taking that action "would do more harm than good to the fund." *Id.* at 429-430.

In this case, the courts below and the parties have largely focused on *Dudenhoeffer*'s third consideration. But nothing in *Dudenhoeffer* suggests that the three considerations are independent criteria. In the government's view, to intelligently consider whether public disclosure would do "more harm than good," it is important first to address *Dudenhoeffer*'s other considerations. The government will address each consideration in turn.

1. ERISA's duty of prudence cannot require ESOP fiduciaries to violate the securities laws' disclosure requirements

First, "the duty of prudence, under ERISA as under the common law of trust, does not require a fiduciary to break the law." *Dudenhoeffer*, 573 U.S. at 428 (citation omitted); see Restatement (Second) of Trusts § 166 cmt. a (1959) (Restatement (Second)). Publicly traded companies that offer a voluntary, contributory ESOP are required to register the ESOP's offers and sales under the Securities Act of 1933, ch. 38, Tit. I, 48 Stat. 74 (15 U.S.C. 77a *et seq.*), and their ESOP's transactions

are subject to the securities laws' antifraud provisions. See *Employee Benefit Plans*, SEC Release No. 6188, 1980 WL 29482, at *9-*11 (Feb. 1, 1980). Such ESOPs are also subject to reporting requirements under the Exchange Act. 17 C.F.R. 240.15d-21, 249.311. ERISA expressly contemplates corporate insiders serving as ERISA fiduciaries for such companies, 29 U.S.C. 1108(c)(3), and the practice is common, *Dudenhoeffer*, 573 U.S. at 423. But as the Court recognized in *Dudenhoeffer*, that practice raises the potential for conflict between the fiduciary's obligations under the securities laws and his ERISA fiduciary duties.

The fact that the ERISA duty of prudence cannot require a fiduciary to violate his securities-laws obligations, *Dudenhoeffer*, 573 U.S. at 428, has important implications in this context. As the Court recognized, that imperative will affect the ESOP fiduciary's investment decisions on behalf of the plan. Section 10(b) of the Exchange Act and Rule 10b-5, 17 C.F.R. 240.10b-5, prohibit a corporate insider from "trad[ing] in the securities of his corporation on the basis of material, nonpublic information." *United States* v. *O'Hagan*, 521 U.S. 642, 651-652 (1997). Thus, as the Court observed, ERISA's duty of prudence cannot require an ESOP fiduciary to "divest[] the fund's holdings of the employer's stock on the basis of inside information." *Dudenhoeffer*, 573 U.S. at 428.

Rule 10b-5 will also affect the fiduciary's ability to prevent the plan or plan participants from making additional purchases. Ordinarily, declining to purchase stock based on inside information would not violate the insider trading rules. An ESOP fiduciary, however, who deviates from an ESOP's pre-authorized trading plan by suspending ESOP purchases, but not ESOP

sales, would expose himself to insider trading liability for the sales. See 17 C.F.R. 240.10b5-1(c)(1)(i)(C). To avoid violating insider trading laws, an ESOP fiduciary with inside information may not suspend ESOP purchases without suspending ESOP sales as well. See 29 U.S.C. 1021(i) (providing a formal mechanism for instituting such a "blackout period"). But purchasing and selling shares of employer stock according to a preexisting contract or pre-authorized trading plan, including an ESOP plan under which the fiduciaries will make purchases and sales on behalf of individual participants or the plan itself, would generally not violate the insider trading rules. See 17 C.F.R. 240.10b5-1(c).

Finally, as most relevant here, the securities laws also constrain how an ESOP fiduciary may (and therefore may be required to) disclose material, nonpublic information to the plan's participants and beneficiaries. Disclosure of such information solely to plan participants and beneficiaries would be impermissible. If the disclosure were made on behalf of the publicly traded employer, it would violate the selective disclosure rules under Regulation FD of the Exchange Act. See 17 C.F.R. 243.100. If it were made in violation of the ESOP fiduciary's confidentiality obligations to the employer, it would be an unlawful tip of inside information. *Dirks* v. *SEC*, 463 U.S. 646, 659-661 (1983). Accordingly, any disclosure must be "effected by a public release * * * designed to achieve a broad dissemination to the investing public generally and without favoring any special person or group." *Id.* at 653 n.12; see 17 C.F.R. 243.101(e).

2. An ERISA-based duty to disclose exceeding the securities laws' requirements would generally be inconsistent with the objectives of those laws

Second, under *Dudenhoeffer*, a court must consider whether an "ERISA-based obligation either to refrain on the basis of inside information from making a planned trade or to disclose inside information to the public could conflict with the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws." 573 U.S. at 428. As the Court observed, although Congress expected courts to "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." *Ibid.* (quoting *Black & Decker Disability Plan* v. *Nord*, 538 U.S. 822, 831 (2003)). The Court noted that the view of the SEC "may well be relevant" on that question. *Ibid.* In the view of the SEC and the United States, it would generally be inconsistent with the objectives of the securities laws to impose an ERISA-based duty to publicly disclose inside information in the absence of a securities-laws duty. And the Department of Labor concurs in the conclusion that ERISA does not impose a duty to disclose in those circumstances.

This Court has recognized that the Exchange Act "substitute[d] a philosophy of full disclosure for the philosophy of caveat emptor." *Lorenzo* v. *SEC*, 139 S. Ct. 1094, 1103 (2019) (citation omitted); *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194-195 (1976) ("The Securities Act of 1933 was designed [1] to provide investors with full disclosure of material information * * * , [2] to protect investors against fraud, and [3] to promote ethical standards of honesty and fair dealing."). And

this principle has animated securities laws ever since. See *Kokesh* v. *SEC*, 137 S. Ct. 1635, 1640 n.1 (2017).

Nevertheless, the securities laws "do not create an affirmative duty to disclose any and all" material nonpublic information. *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 45 (2011). "Even with respect to information that a reasonable investor might consider material, companies can control what they have to disclose under [§ 10(b) and Rule 10b-5] by controlling what they say to the market." *Ibid.*; see *id.* at 44 ("Disclosure is required under these provisions only when necessary 'to make . . . statements made * * * not misleading.'") (citation omitted); *Chiarella* v. *United States*, 445 U.S. 222, 235 (1980) ("A duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information."). Other provisions of the securities laws impose mandatory reporting requirements for additional information in certain circumstances. See, *e.g.*, 15 U.S.C. 78m and 78*o*(d) (2012 & Supp. V 2017); 17 C.F.R. 240.13a-1–240.13a-20, 249.306-249.447. "Except for [such] specific periodic reporting requirements (primarily the requirements to file quarterly and annual reports)," however, "there is no general duty on the part of a company to provide the public with all material information." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1432 (3d Cir. 1997) (Alito, J.).

Indeed, public corporations regularly, and legitimately, keep confidential potential merger discussions, new product announcements, and the like. See *Basic Inc.* v. *Levinson*, 485 U.S. 224, 234-235, 239 n.17 (1988) (mergers and acquisitions); *Backman* v. *Polaroid Corp.*, 910 F.2d 10, 16 (1st Cir. 1990) (en banc) (new products). The disclosure of such information in an efficient mar-

ket may well change the stock price, but neither the corporation nor its insiders who possess such information necessarily have a duty under the securities laws to disclose it.[2] And although it would not violate the securities laws to make a full and fair public disclosure of such information in the absence of any securities-laws duty, to construe ERISA to require disclosure of confidential information that the securities laws do not (or do not yet) require to be disclosed could have significant market-distortive effects. The premature disclosure of confidential information during a potential acquisition or disposition, for example, could easily scuttle a deal that, if permitted to proceed, could add real value (or prevent greater loss) to the company, benefitting all shareholders. See, *e.g.*, *SEC* v. *Materia*, 745 F.2d 197, 199 (2d Cir. 1984) ("Because even a hint of an upcoming tender offer may send the price soaring, information regarding the identity of a target is extremely sensitive and zealously guarded."); *United States* v. *Newman*, 664 F.2d 12, 17-18 (2d Cir. 1981) (premature disclosure of a tender offer can "drive up the price of the target company's shares," and the "tender offer will appear commensurately less attractive") (citation omitted); *In re Melvin*, SEC Release No. 3682, 2015 WL 5172974, at *4 & n.31 (Sept. 4, 2015).

The securities laws afford companies discretion around the timing of public disclosures, to permit companies to pursue strategic initiatives in a manner that maximizes value for their shareholders while ensuring that no one purchaser or seller of stock has an

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[2] In many cases, absent an affirmative legal duty to disclose, such persons may have contractual, employment, fiduciary, or other obligations to keep such information confidential. See *O'Hagan*, 521 U.S. at 651-654, 663; 17 C.F.R. 240.10b5-2.

information-access advantage over another with respect to the initiative. Interpreting ERISA to impose a duty to disclose confidential information that exceeds the securities laws' requirements "would be inconsistent with the careful plan that Congress has enacted for regulation of the securities markets," *Chiarella*, 445 U.S. at 235.

Similar concerns counsel against imposing an ERISA-based duty to disclose on ESOP fiduciaries who do not themselves also have a personal securities-laws duty to disclose, even when the company or other corporate officers do have such a duty. An individual on whom the securities laws do not impose such a duty may be less likely to have the familiarity with both the facts and the law to accurately determine what those obligations are. Cf. *Higginbotham* v. *Baxter Int'l Inc.*, 495 F.3d 753, 760-761 (7th Cir. 2007) ("Prudent managers conduct inquiries rather than jump the gun with half-formed stories as soon as a problem comes to their attention. [The company] might more plausibly have been accused of deceiving investors had managers called a press conference before completing the steps necessary to determine just what had happened."). Public companies frequently "designat[e] a limited number of persons who are authorized to make disclosures" that can be considered as made "on behalf of an issuer" to comply with the securities laws. *Selective Disclosure and Insider Trading*, SEC Release No. 7881, 2000 WL 1201556, at *9-*10 & n.44, *20 n.90 (Aug. 15, 2000); see 17 C.F.R. 243.100, 101(c). And, indeed, certain individuals—such as auditors and attorneys representing an issuer—are required to disclose a fraud *internally*. See 15 U.S.C. 78j-1(b), 7245; 17 C.F.R. 205.3; *Digital Realty Trust, Inc.* v. *Somers*, 138 S. Ct. 767, 780

(2018). ERISA should not be construed to impose a duty on an ERISA fiduciary to make a public disclosure in similar circumstances. The risk of harm to a well-functioning market posed by the unilateral disclosure by a well-intentioned, but non-fully informed, ERISA fiduciary would conflict with the objectives of the securities laws' reticulated reporting and disclosure regime.

3. Whether a prudent fiduciary could conclude that a disclosure required by the securities laws would do more harm than good should, absent extraordinary circumstances, be determined by reference to the securities laws

Finally, against this backdrop, whether "a prudent fiduciary in the defendant's position could not have concluded that * * * publicly disclosing negative information would do more harm than good to the fund" should be straightforward. *Dudenhoeffer*, 573 U.S. at 429-430. In all but extraordinary cases, the first two considerations will answer that question. The securities laws' disclosure rules were designed "to protect investors." *Hochfelder*, 425 U.S. at 194-195. There is no sound reason to adopt a different set of disclosure rules to protect those investors who also happen to be investors through an ESOP, or the ESOP itself. Accordingly, a prudent fiduciary could not rely on ERISA as a basis for declining to disclose information that he is required by the securities laws to disclose, and thus for concluding that to do so would do more harm than good to the fund and its participants and beneficiaries. But by the same token, a prudent fiduciary could conclude that not disclosing information that the securities laws do not require him to disclose would be consistent with the objectives of the securities laws, and thus that disclosure would do more harm than good.

To be clear, the fact that a prudent ESOP fiduciary without a personal securities-laws obligation to disclose would rarely, if ever, have an ERISA-based personal duty to publicly disclose inside information does not mean that he has no ERISA-based duty to do something in response to inside information suggesting that the employer's stock is not a prudent investment. 29 U.S.C. 1104. Although personally effecting or attempting public disclosure would be inconsistent with the overall balance and objectives of the securities laws and could reasonably be regarded as doing more harm than good, prudence may require the ESOP fiduciary to urge a co-fiduciary or other responsible corporate officers to make a required disclosure, to utilize internal company reporting mechanisms, or to report possible violations to the SEC, see 15 U.S.C. 78u-6, or the Department of Labor, see 18 U.S.C. 1514A. See *Somers*, 138 S. Ct. at 772-774. None of these steps would present the same risks to investors and the market as an unnecessary and potentially inaccurate public disclosure. Here, however, respondents have challenged only the petitioners' alleged failure to make public disclosure. Pet. App. 15a.

Moreover, ESOP fiduciaries also may be liable if they knowingly participate in or conceal a co-fiduciary's breach of his fiduciary duty and fail to make "reasonable efforts" to remedy that breach. 29 U.S.C. 1105(a)(3). Section 1105(a) "imposes on each trustee an affirmative duty to prevent every other trustee of the same fund from breaching fiduciary duties." *NLRB* v. *Amax Coal Co.*, 453 U.S. 322, 333 (1981); cf. Restatement (Second) § 184 ("If there are several trustees, each trustee is under a duty to the beneficiary * * * to use reasonable care to prevent a co-trustee from committing a breach

of trust or to compel a co-trustee to redress a breach of trust.").

Under Section 1105(a), a fellow ESOP fiduciary who knows or should know that a co-fiduciary is engaging in such a breach of fiduciary duty has an obligation to take reasonable steps to prevent it. In some circumstances, that may also require, after reasonable investigation, urging a co-fiduciary to make a required disclosure, utilizing internal reporting mechanisms, or reporting possible violations to the SEC or to the Department of Labor. But for the same reasons that a prudent ESOP fiduciary who has no personal duty under the securities laws could reasonably conclude that his disclosure would do more harm than good, Section 1105(a) would not require such an action as a "reasonable effort" to prevent a co-fiduciary from breaching his obligations.[3]

B. The Court Of Appeals' And The Parties' Alternative Approaches Are Misguided

1. Petitioners, respondents, and the courts below take a different approach. Although they reach different conclusions on the allegations in this case, each appear to consider the "more harm than good" question largely apart from *Dudenhoeffer*'s other considerations, and each expect a fiduciary to make an ad hoc prediction

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[3] In an amicus brief filed in the Fifth Circuit in *Whitley* v. *BP, P.L.C.*, 838 F.3d 523 (2016), the Department of Labor suggested that, as a matter of "last resort," an ESOP fiduciary without an independent duty to disclose material, nonpublic information may nevertheless have an ERISA-based duty to disclose such information, if he were unable to convince his co-fiduciary to comply with his obligation to do so. Secretary of Labor Amicus Br. 19, *Whitley*, *supra* (No. 15-20282). After further reflection and consultation with the SEC, the United States has reconsidered that position for the reasons explained in the text.

about the likely effects of a public disclosure on the ESOP and its participants and beneficiaries. See Pet. Br. 42-44; Br. in Opp. 17-23; Pet. App. 15a-21a. That approach is misguided, and in our view would not provide an administrable or effective way to "divide the plausible sheep, from the meritless goats." *Dudenhoeffer*, 573 U.S. at 425.

A principal difficulty arises from the fact that ESOPs have multiple participants and beneficiaries who, at any given time, are likely to have competing economic interests. At common law, "[w]hen there are two or more beneficiaries of a trust, the trustee is under a duty to deal impartially with them." Restatement (Second) § 183; see 2 Austin Wakeman Scott, *The Law of Trust* § 183, at 1471 (3d ed. 1967) ("[I]t is the duty of the trustee to deal impartially as among the several beneficiaries."). Recognizing that, "in typical trust situations," fiduciaries will face "unavoidably and thus permissibly conflicting duties to various beneficiaries with their competing economic interests," Restatement (Third) of Trusts § 79 cmt. b (2007), this duty of impartiality does not require fiduciaries to "treat all [such] beneficiaries equally"—an impossible task. George Gleason Bogert et al., *The Law of Trusts and Trustees* § 541 (2d ed. 1993). But it does require that the trustee "endeavor to act in such a way that a fair result is reached with regard" to their competing interests and "not *unnecessarily* show a preference" for one category of beneficiaries over another. *Ibid.* ERISA's fiduciary duties "draw much of their content" from common law standards. *Varity Corp.* v. *Howe*, 516 U.S. 489, 496 (1996). The duty of impartiality is part of the common law of trusts that informs the scope of an ERISA fiduciary's

duties to the participants and beneficiaries of an ERISA plan. See *id.* at 514.

In an efficient market, the disclosure of material, negative information about a company will cause the company's stock price to fall. See *Basic*, 485 U.S. at 246 ("[T]he market price of shares traded on well-developed markets reflects all publicly available information."). Such a drop in price, however, will affect the economic interests of ESOP participants and beneficiaries in varying ways. On the one hand, a lower stock price would make purchases of that stock less costly, benefiting those participants who are building a position in the employer's stock. On the other hand, the drop in the stock price would also decrease the value of the stock that participants already own, and harm those participants who are in the process of selling the employer's stock.

Whether (and to what extent) a given participant's or beneficiary's economic interests would be served by such a disclosure would turn on, among other things, the size of their existing interests in employer stock; the rate at which they are currently buying and will buy additional shares or are selling and will sell shares; and whether the nonpublic information would otherwise become public at a time when it remained material to the company's stock price, and, if so, when it would otherwise be disclosed. The answers to those questions would typically vary among the participants and beneficiaries of any given plan, as would the strength of their respective interests. Both the direction and the strength of those economic interests would turn on information about the future that, in many cases, neither the participant nor a fiduciary would know with reasonable certainty—much less the ERISA plaintiff who

must plead sufficient facts to withstand the "careful judicial consideration" that the pleading standards require. *Dudenhoeffer*, 573 U.S. at 425. And the analysis would only be further complicated by a prudent fiduciary's consideration of the interests of the ESOP itself as a long-term investor, in addition to those of the particular participants who happen to be buying or selling in the short term.

These variations counsel against an attempt to define a prudent fiduciary's ERISA duty by reference to the relative interests of particular buyers, sellers, and holders of stock, instead of by reference to the securities laws. To be sure, in some cases, some inside information may be more likely to come to light or to cause reputational harm to the company once it does. See Pet. App. 16a. But contrary to the court of appeals' reasoning, those observations do not demonstrate that a prudent fiduciary could not have concluded that a disclosure would do more harm than good. Even if disclosure were inevitable and delay would increase the eventual reputational harm, some of the participants in the ESOP would still benefit from the higher stock price until such disclosure occurred. And if what seemed inevitable never occurred, or were overcome by unforeseen events, the harm caused to sellers by an ERISA-based disclosure would only be more acute. Instead of simply eliminating some gains for participants who otherwise would sell their stock before public disclosure, the ESOP fiduciary's unnecessary disclosure would eliminate those gains for all shareholders.

These uncertainties make an ad hoc cost-benefit analysis too indeterminate to serve the meaningful filtering role the Court intended. The better course therefore is to recognize that Congress and the SEC

have already made the judgment about when a public disclosure is and is not required for the protection of investors generally, which include the ESOP fund and its participants, and that requiring a prudent fiduciary to second-guess that judgment by trying to assess whether disclosure would do more harm than good to the ESOP fund and its participants, in particular, would undermine the objectives of the securities laws.

2. Aside from offering an ad hoc approach, petitioners posit two additional grounds for rejecting an ERISA-based duty to disclose even when the securities laws impose a parallel duty. Neither has merit.

a. In their broadest assertion, petitioners contend (Br. 22-32) that an ERISA fiduciary never has a duty under ERISA to use material, nonpublic information "learned in a *corporate* capacity to make decisions in their *fiduciary* capacity," even if a prudent fiduciary could not have concluded that acting on such information would do more harm than good. Br. 22. That contention would preclude a duty-of-prudence claim even where the fiduciary had an independent securities-laws obligation to disclose, but it is also plainly inconsistent with this Court's decisions in *Dudenhoeffer* and *Amgen Inc.* v. *Harris*, 136 S. Ct. 758 (2016) (per curiam).

Both those decisions indicate that an ESOP fiduciary may, in some circumstances, have an ERISA-based obligation to act on the basis of inside information obtained as a company insider. While the Court in *Dudenhoeffer* held that allegations that a fiduciary violated his duty of prudence by failing to outsmart the market based on *publicly available* information "are implausible as a general rule," 573 U.S. at 426, it discussed at length the considerations that should inform whether a complaint plausibly alleges a violation of the duty based

on a fiduciary's failure to act on *inside information*, *id.* at 427-430. None of those considerations is whether the individual acquired such inside information in a corporate or fiduciary capacity. Pet. Br. 22. And, in *Amgen*, the Court repeated *Dudenhoeffer*'s standard as a means of "divid[ing] the plausible sheep from the meritless goats," 136 S. Ct. at 759 (citation omitted), and reasoned that the plaintiffs may have been able to state a plausible claim based on the defendants' failure to halt trading in the employers' stock on the basis of inside information, without any mention of whether that information was obtained in a corporate capacity, *id.* at 760. The Court plainly contemplated that there would be *some* "plausible sheep" to divide from the "meritless goats." *Id.* at 759 (citation omitted).

Petitioners rest their contrary contention on this Court's earlier decision in *Pegram* v. *Herdrich*, 530 U.S. 211 (2000). In that case, the Court held that an HMO did not act in a fiduciary capacity when, through its physician owners, it "ma[de] decisions affecting medical treatment" while influenced by the profit-sharing terms of the HMO scheme. *Id.* at 226. The Court based its conclusion on the fact that medical decisions bear "only a limited resemblance to the usual business of traditional trustees," *id.* at 231, and subjecting such decisions to ERISA's duties would "in effect" accomplish "nothing less than elimination of the for-profit HMO," despite Congress's decades-long promotion of such organizations, *id.* at 233.

Pegram does not control here. *Pegram* concerned whether a particular decision was taken in a fiduciary capacity, not the type of information that a fiduciary could or should consider when making an indisputably

fiduciary decision. Petitioners do not contest that decisions concerning the administration of an ESOP and its investments, such as those complained of here, are fiduciary acts. See Pet. Br. 25. But once this point is conceded, they largely give up the game. See 530 U.S. at 226 (addressing when a defendant "was acting as a fiduciary (that is, was performing a fiduciary function) [by] taking the action subject to complaint"). In any event, even if the reasoning of *Pegram* might bear on the distinct question of what information a fiduciary may or must rely on in making a concededly fiduciary decision, that reasoning does not apply here.

In contrast to a medical decision, decisions about how to protect the investments of an ERISA plan's participants and beneficiaries are the quintessential business of a traditional trustee. That does not change just because the trustee has obtained relevant information by corporate means. Indeed, before the development of insider trading laws, common law trustees were commonly thought to be *required* to seek out and utilize such inside information for their trustees' benefit. See, *e.g.*, Steven R. Hunsicker, *Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions*, 50 S. Cal. L. Rev. 611, 631 (1977) (collecting cases). And in *Varity*, the Court held that an ERISA fiduciary violated its duty of loyalty by making statements to its beneficiaries that it knew to be false based on Varity's corporate plans. 516 U.S. at 493, 506. When a person acts in the capacity of both ERISA fiduciary and corporate insider, the latter role is part of the statutory inquiry of what a person "acting in a like capacity" would do. 29 U.S.C. 1104(a)(1)(B). It would be improper to require an insider to empty his

head of all corporate knowledge when he dons an ERISA hat.

Unlike the for-profit HMOs in *Pegram*, moreover, there is no reason to believe that requiring an ERISA fiduciary to act on inside information would compel the elimination of ESOPs or even, as petitioners contend (Br. 22), prevent company insiders from serving as ESOP fiduciaries. Far from creating conflict with those individuals' obligations under the federal securities laws, the Court made clear in *Dudenhoeffer* that the scope of ERISA's duty of prudence must be interpreted in light of those laws and their objectives. 573 U.S. at 429. While petitioners' argument is premised on the notion that avoiding such conflict is infeasible, the position advanced by the government here demonstrates that it is entirely feasible. And petitioners' concerns about an ERISA duty to disclose "above and beyond the requirements of the securities laws," Br. 28, largely fall away.

b. Petitioners also contend that permitting ERISA fiduciary claims to proceed, even where petitioners' allegations would establish that an insider fiduciary failed to make a disclosure required by the securities laws, would "impose heightened ERISA duties on dual-capacity fiduciaries" and "allow the circumvention of limitations on securities suits deliberately fashioned by Congress." Pet. Br. 31 n.3; see *id.* at 58-60. But imposing an ERISA duty to disclose only when the fiduciary already possesses a securities-laws duty to disclose does not meaningfully impose "heightened" duties on anyone. It may be true that dual-capacity fiduciaries will more often have a securities-laws duty to disclose than independent ESOP fiduciaries, and therefore more often have a corresponding ERISA duty. But although

it derives from a different statute, the legal duty itself is not heightened at all.

The real objection, then, to an ERISA duty in these circumstances cannot be to a heightened legal *obligation*, but rather to the potential for additional *liability*, through the creation of what petitioners characterize as an "end-run around the strict standards that Congress has enacted to rein in abusive securities litigation" in the PSLRA. Pet. Br. 58; see *id.* at 56-60. That is a concern, but it is overstated. The PSLRA does not apply to duty-of-prudence claims under ERISA. See 15 U.S.C. 78u-4(a)(1) ("The provisions of this subsection shall apply in each private action arising *under this chapter*.") (emphasis added). That does not mean, however, that ERISA plaintiffs may plausibly state a duty-of-prudence claim through merely generalized allegations of securities fraud.

This Court has already made clear that on a motion to dismiss, a duty-of-prudence claim must be subjected to a "careful, context-sensitive scrutiny." *Dudenhoeffer*, 573 U.S. at 425. And the Court has instructed district courts to consider not only whether a prudent fiduciary could not have concluded that public disclosure would do more harm than good, but also whether requiring such a disclosure would have furthered or conflicted with the objective of the securities laws. *Id.* at 429-430. Given the risks inherent in premature or inaccurate public disclosures, meeting the ERISA pleading requirements should entail more than generic allegations that a securities-laws violation has occurred; instead, to state an ERISA claim based on a failure to make a public disclosure, complaints should allege sufficient facts to establish that the defendants themselves actually had such a securities-laws-based duty and that,

based on the circumstances at the time, those defendants plausibly knew or should have known the facts giving rise to that duty.

C. The Court Should Vacate The Judgment Below And Remand The Case To Allow The Court Of Appeals To Apply The Correct Standard In The First Instance

The court of appeals held that respondents plausibly alleged that, in the circumstances of this case, a prudent fiduciary could not have concluded that effecting a public disclosure would have done more harm than good. Pet. App. 15a. But the court reached that conclusion by invoking an ad hoc balancing approach to determining when a public disclosure would do more harm than good, rather than considering the judgment reflected in the securities laws; and neither the district court nor the court of appeals considered whether respondents plausibly alleged that each individual petitioner had an independent legal duty to make such a disclosure. Because neither court below applied the correct legal standard in determining whether respondents have plausibly alleged a violation of ERISA's duty of prudence, they should be given the first opportunity to apply that standard here.

CONCLUSION

The judgment of the court of appeals should be vacated and the case remanded for further proceedings.

Respectfully submitted.

RACHEL MONDL
Deputy Solicitor of Labor
G. WILLIAM SCOTT
Associate Solicitor
THOMAS TSO
Counsel for Appellate and Special Litigation
EIRIK CHEVERUD
Trial Attorney
Department of Labor

ROBERT B. STEBBINS
General Counsel
MICHAEL A. CONLEY
Solicitor
DAVID D. LISITZA
Senior Litigation Counsel
Securities and Exchange Commission

NOEL J. FRANCISCO
Solicitor General
EDWIN S. KNEEDLER
Deputy Solicitor General
JONATHAN Y. ELLIS
Assistant to the Solicitor General

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