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In *Burke v. Boeing*, Seventh Circuit Aptly Rejects ESOP Beneficiaries' Stock-Drop Insider Claims

by DeMario Carswell and Jaime Santos

On August 1, 2022, the U.S. Court of Appeals for the Seventh Circuit issued an opinion affirming the district court's decision dismissing a stock-drop case in *Burke v. The Boeing Company*, 42 F.4th 716 (2022). Before discussing this case, it may be helpful to understand the recent history in this litigation space. Under ERISA, fiduciaries are permitted to offer a company's employees the opportunity to have an ownership interest in the company they work for by owning company stock through their retirement plans. This is generally done through an employee stock ownership plan ("ESOP") through their 401(k) plan. What many plan sponsors offering this option learned in the early 2000s is that no good deed goes unpunished. Plaintiffs' law firms raced to courts across the country to file ERISA lawsuits alleging a breach of the fiduciary duties of prudence and loyalty against these companies whenever an ESOP experienced a financial downturn that led to a stock-price decrease.

The most common allegations in these lawsuits were that plan fiduciaries had insider information about corporate financial situations that indicated the company stock price was inflated, but the company continued to offer stock to 401(k) plan participants through the ESOP. Some lawsuits also alleged that corporate officials should not have served as plan fiduciaries at all, even though ERISA expressly permits corporate officers to serve as fiduciaries in the employer's 401(k) plan. ERISA plaintiffs would frequently allege that serving in those dual roles create a conflict of interest that the company should have avoided by retaining an independent fiduciary to make investment decisions for the ESOP.

Before 2014, most courts applied a presumption (called the "*Moench* presumption") that, in light of Congress's express authorization of ESOPs, fiduciaries offering employer stock were presumed to have acted prudently in making the stock available as an investment option. The Supreme Court eliminated that presumption in a case called *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014), but articulated a high bar for ERISA plaintiffs to plead a plausible claim of fiduciary breach in the ESOP context. *Dudenhoeffer* requires plaintiffs to allege an alternative action (besides retaining company stock as an option in the 401(k) plan) that could have been taken without violating securities laws and that no prudent fiduciary could have concluded would do more harm than good to the plan. As a result of this standard, most stock-drop cases have been rejected at the pleading stage since *Dudenhoeffer*. As courts have recognized, virtually all the alternative actions that plaintiffs have pleaded—*e.g.*, freezing investment in company stock or removing company stock as an investment option—could have a huge impact on the market, tanking the stock price and creating losses for plan participants already invested.

In *Burke*, participants of Boeing's 401(k) Plan sued Boeing (the employer that sponsored the plan) and members of two committees that were responsible for managing and making investment decisions related to the plan. *Burke* was in some ways a classic ERISA stock-drop suit—as explained below, plan fiduciaries were sued for continuing to offer company stock in the 401(k) plan lineup despite allegedly knowing information that, if disclosed, could have caused investors to flee. But there was a catch—unlike most ERISA stock-drop suits, none of the defendants who the plaintiffs sued had any discretion about whether company stock would continue to be offered in the plan. Instead, they had delegated that authority to an independent

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fiduciary, Newport Trust—just as scores of ERISA plaintiffs had faulted *other* plan sponsors and fiduciaries for *failing* to do. Yet Boeing was still sued.

The plaintiffs filed suit shortly after Boeing announced it would ground the 737 Max aircrafts following two fatal crashes of Boeing aircrafts that resulted in the death of all passengers aboard. Boeing's stock price dropped substantially. In addition to various securities lawsuits and government investigations, participants in Boeing's 401(k) plan filed a class-action complaint under ERISA. The crux of their argument was that Boeing should have publicly disclosed that the 737 Max was unsafe after the recovery of the flight data recorder from the first crash; that failing to disclose that information was an intentional concealment that caused Boeing Stock to be artificially inflated and later resulted in Boeing Stock's value dropping; and that by not making this disclosure, the defendants breached their duties of prudence and loyalty.

The district court dismissed the case at the pleading stage, and the Seventh Circuit affirmed, agreeing that the plaintiffs' complaint suffered from a fatal defect: none of the defendants were fiduciaries with respect to the actions subject to the lawsuit—the decision whether to retain Boeing Stock in the company's 401(k) plan. Boeing had delegated that authority to an independent fiduciary *precisely to avoid* the issue of divided loyalties that had inspired dozens of past ERISA stock-drop lawsuits. As the court explained, ERISA fiduciary status is not all-or-nothing: an individual or entity can be a fiduciary with respect to some decisions and not others. And here, because all investment decisions relating to Boeing Stock were delegated to an independent fiduciary, the defendants did not act in an ERISA fiduciary capacity with respect to Boeing Stock. Their delegation decision had to be prudent and loyal, of course—as the Seventh Circuit explained, "A plan sponsor could not delegate its duties to people or entities if it had reason to doubt their ability to carry out their duties competently or honestly." But, the court said, "there is no plausible claim here that the first delegation violated either of those duties." At bottom, the court concluded, the defendants could not "be liable for breaching fiduciary duties that they simply did not have."

The court further agreed that even if the defendants had been considered fiduciaries with respect to Boeing Stock, the plaintiffs' breach of duty of prudence claim could not have survived the demanding pleading standard discussed above from *Dudenhoeffer*. As many other courts have recognized, simply alleging that plan fiduciaries could have made a "public disclosure" of information about Boeing aircrafts that could have led to a stock drop and harmed participants already invested in the ESOP does not plead "circumstances under which a prudent fiduciary could not have concluded that such disclosures would do more harm than good to Plan participants." Moreover, the court noted, unlike securities laws, disclosure duties under ERISA are generally limited to avoiding misleading statements. The court explained that it was "not persuaded that ERISA imposes such a duty that would be layered on top of federal securities laws governing public disclosures of information material to investors."

Finally, the court reached the same conclusion as to the plaintiffs' claim that the defendants breached their fiduciary duty of loyalty. The court agreed with other circuits that "plaintiffs cannot use the broader and more general duty of loyalty 'to circumvent the demanding *Dudenhoeffer* standard' for duty of prudence claims."

The *Burke* decision is an example of how courts will be hesitant to fault a plan sponsor for doing exactly what plaintiffs have consistently argued for years—retain an independent fiduciary. The decision further provides guidance for ERISA fiduciaries when analyzing the appropriate level of governance for their own plans. Even though not required by ERISA, in some cases an additional level of plan governance in the form of an investment manager may be beneficial where plan sponsors and their committees are dealing with investment options—and specifically with ESOPs and company stock plans—for their participants that may be a target for plaintiffs' law firms to focus on what they perceive as a potential tension between ERISA and federal securities laws. As the court noted in *Burke*, there has been an increase in the use of independent investment advisors like Newport, in part to mitigate the of risk or allegations of conflict that plan sponsors may face when dealing with employer stock.

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