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Division of Fiduciary Duties Proves Key to Success in Stock Drop Lawsuit

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On August 1, 2022, the United States Court of Appeals for the Seventh Circuit affirmed the lower court's dismissal of a "stock drop" lawsuit against Boeing. The Seventh Circuit based its conclusion on the fact that an independent fiduciary, rather than the Boeing defendants, had exclusive fiduciary responsibility for the company stock fund and therefore had no duty to disclose corporate insider information to the participants or the independent fiduciary.

This ruling continues the trend since the Supreme Court's ruling in *Fifth Third Bancorp v. Dudenhoeffer* where the Court set "demanding pleading standards" that require plaintiffs to "plausibly allege an alternative action the defendant could have taken that would have been consistent with securities law and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the employee stock ownership fund than to help it." *Burke v. Boeing Co.*, This pleading standard has proven challenging for plaintiffs to overcome.

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I. Background

The litigation was filed in the wake of two accidents involving Boeing's 737 Max aircraft. The plaintiffs alleged that following the first accident, the defendants "knew or should have known" that non-public information concerning aircraft safety issues "would inevitably become public," and thus "should have issued a corrective, public disclosure regarding the safety of the 737 MAX airplanes." The plaintiffs further alleged that the "failure to issue a corrective disclosure resulted in unnecessary reputational harm which further depressed Boeing's share price" and resulted in the plan and participants purchasing company stock at an inflated price.

II. Seventh Circuit's Opinion

A threshold issue in a "stock drop" case is whether the defendant was acting as a fiduciary with respect to the investment in question. Although not new ground, the opinion contains clear and concise explanation of the "functional fiduciary" and "two-hat" concepts under ERISA. The impact of delegations on the duties owed to the plan by the defendants was also examined by the court.

Using the plan documents, the Seventh Circuit determined that neither Boeing, the individual defendants, nor the Boeing plan committees had fiduciary responsibilities for managing the company stock fund. Similarly, the scope of responsibility of the plan administrator, a named fiduciary, did not include any investment functions as outlined in the plan documents. Further, the delegation from the plan sponsor to the committee was not challenged by the plaintiffs as being improper such that it was ineffectual. "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."

Next, the court stated that *exclusive* fiduciary responsibility for monitoring and retaining the Boeing stock in the investment line-up was delegated to the *sole discretion* of an independent fiduciary by the fiduciary committee that held the investment functions. This delegation prevented the risk of claims against insider-fiduciaries for having corporate insider information that should or could have been acted upon while serving as a plan fiduciary.

The court dismissed the plaintiff's argument that the duty of loyalty included a non-delegable duty to disclose non-public information to plan participants, which would require full public disclosure to all shareholders and potential investors. The court stated that a violation of ERISA's disclosure requirement "requires evidence of either an intentionally misleading statement, or a material omission where the fiduciary's silence can be construed as misleading." In other words, plan fiduciaries are not required to provide all information about the defendant corporation's business decisions as they occur to plan participants. The court also concluded that, contrary to the plaintiff's assertion, the duty to monitor appointees does not include a non-delegable duty to keep appointees apprised of material, non-public information regarding the prudence of a plan investment. Such a requirement would run contrary to the attempts to remove conflicting loyalties by using an independent fiduciary.

The dismissal reinforces the high pleading standards for complaints related to company stock. Further, the opinion provides insights into the scope of fiduciary duties, including how such duties may be divided or delegated. There are insights specific to internal divisions and some specific to the use of third party independent fiduciaries that are well worth remembering when creating or changing a plan governance structure regardless of whether the plan offers company stock as an investment option.