IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

In re DELL INC. ERISA LITIGATION	)))	Case No. A-06-CA-758-SS

DEFENDANTS' MOTION TO DISMISS AND MEMORANDUM IN SUPPORT

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Pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, Defendants[1] respectfully request that, for the reasons set forth below, Plaintiffs' Second Amended Class Action Complaint ("Complaint") be dismissed with prejudice and that judgment be entered in Defendants' favor.

INTRODUCTION

This case is one of a growing number of ERISA class action 401(k) Plan "stock-drop cases" that are automatically filed on the heels of securities fraud lawsuits. Securities fraud plaintiffs claim that management misled them about the company's prospects and, as a result, they bought "artificially inflated" stock. The Dell ERISA Plaintiffs mirror these claims and say they too purchased "artificially inflated" Dell stock for their Dell Inc. 401(k) Plan (the "Plan") accounts. Like the securities fraud plaintiffs, the Dell ERISA Plaintiffs point to a series of alleged misrepresentations about Dell's economic performance as forming the factual basis for all four of their Employee Retirement Income Security Act of 1974 ("ERISA") fiduciary breach claims.[2] According to Plaintiffs, a proper

[1] Plaintiffs name as defendants in their Complaint: (1) Dell Inc. ("Dell"); (2) Michael Jordan, Klaus Luft, and Michael Miles (the "Director Defendants"); and (3) Thomas Welch, Dominick DiCosimo, and Brian MacDonald (the "Committee Defendants"). This motion is filed on behalf of all defendants.

[2] Count I alleges that Dell and the Committee Defendants (the "Prudence Defendants") failed to prudently and loyally manage the Plan and assets of the Plan by misrepresenting Dell's true financial condition and by allowing the Plan's participants to continue investing in Dell stock during the period from May 16, 2002 to present (the "Class Period"). The remaining three claims in the Complaint are derivative of the prudence claim alleged in Count I. If Plaintiffs' breach of the duty of prudence claim fails, so too must the claims for failure to disclose complete information as to Dell and the Committee Defendants (Count II), for failure to monitor/failure to provide complete information as to the Director Defendants (Count III), and for co-fiduciary liability as to all Defendants (Count IV).

fiduciary, upon learning of these misrepresentations, would have eliminated the Dell Stock Fund as a Plan investment option, and would have sold the Plan's investments in Dell stock on the first day of the Class Period, May 16, 2002 (when Dell's closing stock price was $27.85). Even though Dell has remained profitable and the price of its stock never closed below $19.91 during the Class Period, Plaintiffs nonetheless assert their Plan accounts were damaged by these alleged misrepresentations. Under ERISA, the controlling question is not whether there was "artificial inflation" in the price of Dell stock as alleged in the Complaint but: (1) whether temporary fluctuations in the price of Dell stock resulting from the alleged misrepresentations made holding Dell stock an imprudent Plan investment; and (2) whether the Defendants' alleged misrepresentations about Dell's financial performance are actionable.

Plaintiffs' Complaint ultimately fails for the following reasons:

- Congress has expressly authorized investment in company stock and has immunized those investments from liability for failure to diversify;

- Plaintiffs fail to plead that Dell's stock was or is an imprudent investment since the market value of Dell's stock never experienced a "precipitous decline" nor raised concerns of an "impending collapse"; and

- Plaintiffs' claims are based on alleged misrepresentations and are equitable in nature, yet Plaintiffs cannot plead the required elements of equitable estoppel.

Dell stock was not and is not an imprudent Plan investment under ERISA. In light of ERISA's statutory protections for company stock investments, and the Congressional purpose behind them, courts have held that a fiduciary's decision to invest in company stock can be challenged, if at all, only under a deferential "abuse of discretion" standard. Under the abuse of discretion standard, which is also referred to as the "presumption of prudence," the Dell fiduciaries are presumed to have acted prudently in acquiring and holding company stock.

To show the Dell fiduciaries abused their discretion by retaining Dell stock in the Plan, Plaintiffs must allege a "precipitous decline" in the price of Dell stock, plus other extreme circumstances. Yet, no precipitous decline occurred. A temporary decline in the price of 401(k) plan-held stock is not a sufficient factual predicate for a fiduciary breach claim. *Edgar v. Avaya, Inc.*, 503 F.3d 340, 348-49 (3d Cir. 2007); *Wright v. Or. Metallurgical Corp.*, 360 F.3d 1090, 1098-99 (9th Cir. 2004). Indeed, the SEC filings and press releases identified in the Complaint demonstrate that investing in Dell stock was prudent, and further confirm that Dell remains a very healthy stock. (Complaint ¶¶ 69-81.)[3] For example, between Fiscal 2005 and Fiscal 2007 Dell repurchased over $14.4 billion of its own stock on the open market.[4] Furthermore, during the Class Period, Dell's available cash, cash equivalents, and investments grew from $8.2 billion (First quarter Fiscal 2003) to $12.4 billion (Fourth quarter Fiscal 2007).[5] Between Fiscal 2003 and Fiscal 2007, Dell's net

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[3] "Documents that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim." *Causey v. Sewell Cadillac-Chevrolet, Inc.*, 394 F.3d 285, 288 (5th Cir. 2004) (citation omitted).

[4] *See* Dell Inc., Annual Report (Form 10-K), at 50, 63 (Oct. 30, 2007) ("During Fiscal 2007, we repurchased approximately 118 million shares at an aggregate cost of $3.0 billion compared to 204 million shares at an aggregate cost of $7.2 billion in Fiscal 2006 and 119 million shares at an aggregate cost of $4.2 billion in Fiscal 2005.") (excerpts attached hereto as Exhibit 1).

[5] *See id.* at 21, 34.

revenues grew from $35.3 billion to $57.4 billion.[6] During this same time period, gross margin increased from $6.4 billion to $9.5 billion.[7]

Plaintiffs' Complaint fails to allege knowledge on the part of Plan fiduciaries that Dell's viability as a company was ever threatened. To show the Dell fiduciaries abused their discretion in retaining Dell stock, Plaintiffs must, at a minimum, allege (and later prove) that the Dell fiduciaries "fiddled while Rome burned" even though they knew Dell was facing "impending collapse." *Avaya*, 503 F.3d at 348-49. Yet, the facts alleged in the Complaint indicate the exact opposite situation occurred – Dell's business grew significantly throughout the Class Period. As a long-term investment, Dell stock has performed extraordinarily well.[8] Had Defendants sold the Plan's stock as Plaintiffs allege, Defendants would have been undoubtedly sued under ERISA for selling Dell stock prematurely.[9]

The Complaint fails for yet another reason. All four of the fiduciary breach claims are based on equitable estoppel-type allegations of misrepresentation. Dell's stock price was artificially inflated, according to these allegations, because Defendants misrepresented "information regarding Dell's business and financial circumstances."

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[6] *See id.* at 21.

[7] *Id.*

[8] Dell stock has split seven times since it was initially offered to the public in 1988 for $8.50 per share (the equivalent of approximately $.09/share today on a split-adjusted basis).

[9] *See, e.g., Tatum v. R.J. Reynolds Tobacco Co.*, 392 F.3d 636, 639-40 (4th Cir. 2004) (ERISA fiduciary sued for selling employer stock too soon, *i.e.*, before it appreciated in value). *See also Pedraza v. Coca-Cola Co.*, 456 F. Supp. 2d 1262, 1275-76 (N.D. Ga. 2006) (dismissing claim that fiduciary should have acted contrary to plan provisions and sold employer stock in face of drop in price where company was not "on the brink of collapse," and recognizing that a "fiduciary who decides to scrap the ESOP is just as apt to be sued as he would be if he enforced the plan provisions").

(Complaint at ¶ 61; *see also id.* at ¶ 98.) Yet, to state an ERISA fiduciary breach claim on this theory, a plaintiff must plead (and eventually prove) that the damages his retirement account suffered were caused by the fiduciary's improper conduct, ERISA § 409(a), 29 U.S.C. § 1109(a) (2006); *Ferrer v. Chevron Corp.*, 484 F.3d 776, 782 (5th Cir. 2007), and that the elements of equitable estoppel are satisfied, including that Plaintiffs relied to their detriment on alleged material misrepresentations made by Defendants. Plaintiffs have failed to plead these required elements.

As set forth in detail below, Plaintiffs do not – and cannot – set forth sufficient allegations to state a claim for breach of any duty under ERISA. Accordingly, the Court should grant Defendants' motion and dismiss the Complaint with prejudice.

STATEMENT OF FACTS

Dell is one of the world's leading suppliers of information technology and Internet infrastructure products. (Complaint ¶ 18.) "During calendar year 2005, Dell was the number one supplier of personal computer systems worldwide, as well as in the United States." (*Id.*) As of March 15, 2006, it employed approximately 65,200 employees worldwide. (*Id.*) Dell is a publicly traded corporation, and its common stock is listed on the NASDAQ under the symbol "DELL." (*Id.*)

As part of its benefits package, Dell offers its eligible employees the option of participating in the Plan. Dell is the sponsor of the Plan and acts as its administrator. (Complaint ¶ 21, Exh. A, Plan § 10.1.) An administrative committee appointed by Dell's directors serves as the Plan's named fiduciary. (Complaint, Exh. A, Plan §§ 1.1(e), 10.1.) During the Class Period, the Plan's assets have been held in trust by JPMorgan Chase Bank, N.A. (Complaint ¶ 23.) The Plan is specially designed as a profit-sharing plan. (Complaint, Exh. A, Plan § 1.5.) As such, it qualifies as an "eligible individual account plan" ("EIAP") under ERISA. ERISA § 407(d)(3)(A), 29 U.S.C. § 1107(d)(3)(A) (2006).[10]

The Plan is "specifically authorized to acquire and hold up to 100% of its assets in [Dell] [s]tock." (Complaint, Exh. A, Plan § 16.5.) In practice, however, the Plan offers participants a menu of fifteen different investment options "for [their] investment [d]iversification needs." (*See*, *e.g.*, Complaint, Exh. J, 2007 Summary Plan Description ("SPD") at 10-11.) The available investment options include ten "core funds" and five "Pre-Mixed Portfolios." (*Id.*) The Core Funds consist of individual investment funds "rang[ing] from lower to higher risk." (*Id.* at 11.) The Pre-Mixed Portfolios "[are] made up of a diversified mix of professionally-managed core funds." (*Id.*) The Pre-Mixed Portfolios were added to the Plan in 2004 to provide "a diversified investment solution designed for [p]articipants seeking a single investment option." (*Id.*)

Participants are free to choose how they invest their Plan accounts. (Complaint, Exh. K, 2005 SPD at 11.) Plaintiffs concede that Plan participants "could cause the Plan to invest the assets held in each of their accounts among [the] investments funds offered by the Plan." (Complaint ¶ 33, Exh. A, Plan § 5.1.) Plan participants have complete freedom to "choose the combination of investment options that best meet [their] personal and financial goals." (Complaint, Exh. J, 2007 SPD at 10.) They can change their

[10] The Plan allows a participant to make contributions ranging from 0% to 25% of his or her "Considered Compensation" for the Plan year. (Complaint ¶ 26, Exh. A, Plan § 3.1(a).) Dell matches 100% of the contributions made by its employees up to 3% of the employees' total compensation. (Complaint ¶ 28, Exh. A, Plan § 3.2(a).)

investment selections at any time via Dell's Intranet or by contacting the Dell Benefits Center. (*Id.* at 13.) The Dell Company Stock Fund is one of the ten Core Funds offered (*id.* at 11), and it invests in Dell common stock. (*Id.* at 19.) As Dell employees, Plan participants "may invest in the Dell Stock Fund, but … are not required to do so." (*Id.*)

Because the Dell Stock Fund invests virtually all of its assets in a single security, it is described as a non-diversified, high-risk investment option. (*Id.* at 13.) Throughout the Class Period, Plan participants were expressly warned about the potential risks associated with investing in the Dell Stock Fund:

> An investment in the Dell Stock Fund involves a high degree of risk. The value of the fund is directly related to the price of Dell common stock. If Dell common stock loses value, your investment in the Dell Stock Fund will also lose value. Additionally, because the Dell Stock Fund invests virtually all of its assets in one security, it will likely experience a higher level of volatility, and involves a higher degree of risk, than other investment alternatives available under the Plan.

(Complaint, Exh. M, 2003 SPD at 30; Exh. L, 2004 SPD at 30; Exh. K, 2005 SPD at 22; Exh. J, 2007 SPD at 19-20.) Indeed, participants are on notice that it is "possible to lose money if [they] invest in the Dell Stock Fund." (*See*, *e.g.*, Complaint, Exh. M, 2003 SPD at 30.)

ARGUMENT

To avoid dismissal under Rule 12(b)(6), "a complaint must contain either direct or inferential allegations respecting all the material elements necessary to sustain recovery under *some* viable legal theory." *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955, 1969 (2007) (internal quotation and citation omitted). "A plaintiff's obligation to provide the 'grounds' of his 'entitle[ment] to relief' requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do … ." *Id.* at 1964-65. Factual allegations in the complaint must be definite enough to "raise a right to relief above the speculative level" and a plaintiff must plead "enough facts to state a claim to relief that is plausible on its face." *Id.* at 1965, 1974.

I. The Dell Stock Fund Is Not An Imprudent Investment.

A. ERISA's Duty of Prudence Does Not Require A Plan Fiduciary To Diversify The Plan's Investment In Employer Stock.

Count I encompasses Plaintiffs' fundamental claim that Dell stock was an "imprudent" retirement plan investment. Although Plaintiffs parrot ERISA's "prudent man" standard and allege that the Prudence Defendants breached that standard by failing to sell the Plan's investments in Dell stock (the "Prudence Claims"), these Prudence Claims are effectively disguised arguments that the Prudence Defendants should have reduced the risk of loss by selling (i.e., diversifying) the Dell stock held by the Plan. Plaintiffs admit that "a fiduciary's duty of prudence does not include a general duty to diversify with respect to qualifying employer securities" (Complaint ¶ 66); indeed, the law expressly *exempts* programs like the Dell Stock Fund from the duty to diversify. Diversification claims, even when in disguise, are foreclosed by the express terms of ERISA.[11]

Congress promulgated special statutory rules to promote employee ownership of employer stock[12] and to encourage investment in company securities by EIAPs, such as

[11] Furthermore, even if ERISA required diversification, Plaintiffs' claim fails because the Plan's menu of fifteen different investment vehicles is diverse on its face.

[12] Several other provisions of the Tax Code specifically encourage employee stock ownership through ERISA plans. I.R.C. §§ 404(a)(9) (special tax deductions for plan sponsors), 404(k) (special tax deductions for plan sponsors), 415(c)(6) (favorable treatment for certain annual

401(k) plans.[13] "[T]he concept of employee ownership constitute[s] a goal in and of itself." *Moench v. Robertson*, 62 F.3d 553, 568 (3d Cir. 1995). Thus, Congress encouraged the establishment of EIAPs and granted them favorable treatment under several statutes, including ERISA. *See Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983) ("Congress has repeatedly expressed its intent to encourage the formation of ESOPs [a subset of EIAPs], by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that goal." (Footnotes omitted.)). Unlike traditional pension plans governed by ERISA, EIAPs are not intended to guarantee retirement benefits because by their nature they "place[] employee retirement assets at much greater risk than does the typical diversified ERISA plan." *Martin*, 965 F.2d at 664.

To encourage employers to establish employer stock programs, Congress expressly exempted those programs from the provisions of ERISA that might impede their implementation or effectiveness – including the duty to diversify plan assets: "[T]he diversification requirement … and the prudence requirement (only to the extent it requires diversification) … is not violated by acquisition … of … qualifying employer securities …." ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2) (2006). *See Avaya*, 503 F.3d at 347 ("§ 1104(a)(2)

(continued…)

additions to participants' accounts), 1042 (income tax deferral for sellers of stock to ESOPs). *See also* ERISA §§ 406, 408(e)(3)(A), 29 U.S.C. §§ 1106, 1108(e)(3)(A) (2006) (exempting fiduciaries from ERISA's strict prohibitions against self-dealing and conflicts of interest with respect to investment in employer stock). *See also Brown v. Am. Life Holdings, Inc.*, 190 F.3d 856, 860 (8th Cir. 1999); *Martin v. Feilen*, 965 F.2d 660, 664-65 (8th Cir. 1992).

[13] An EIAP is a profit sharing, thrift, savings, or employee stock ownership plan whose governing documents allow the plan to acquire and hold employer stock. ERISA § 407(d)(3)(B), 29 U.S.C. § 1107(d)(3)(B) (2006).

provides that all EIAPs, not just ESOPs, are exempt from ERISA's duty to diversify."). ERISA's legislative history leaves no doubt that Congress *never* intended the prudent man standard to restrict a fiduciary's decision to invest plan assets in company stock:

> In recognition of the special purpose of profit-sharing and similar plans, the limitation [on holding employer stock] does not apply to such plans … *nor should any diversification principle that may develop from application of the prudent man principle be deemed to restrict investment by profit-sharing plans in employer securities.*

S. Rep. No. 93-127 (1974) *as reprinted in* 1974 U.S.C.C.A.N. 4838, 4869 (emphasis added). *See also* H.R. Rep. 93-1280 (1974) *as reprinted in* 1974 U.S.C.C.A.N. 5038, 5097.

Courts have ruled that plaintiffs in stock drop cases cannot avoid ERISA's statutory diversification exemption by disguising their allegations as "prudence" claims. "Congress fashioned a bright-line exclusion for [EIAP] fiduciaries from liability for their alleged failure to sell company stock." *In re McKesson HBOC, Inc. ERISA Litig.,* 391 F. Supp. 2d 812, 828 (N.D. Cal. 2005). As the *McKesson* court reasoned, "[i]f there is no duty to diversify [EIAP] plan assets under the statute, it logically follows that there can be no claim for breach of fiduciary duty arising out of a failure to diversify, or in other words, arising out of allowing the plan to become heavily weighted in company stock." *Id.* at 819. Indeed, "[i]nterpreting ERISA's prudence requirement to subject EIAPs to an albeit tempered duty to diversify arguably threatens to eviscerate congressional intent and the guiding rationale behind EIAPs themselves." *Wright,* 360 F.3d at 1097. These strong expressions of Congressional policy bolster judicial decisions that claims such as Count I, alleging fiduciary breach for failure to diversify out of Dell stock, cannot withstand the exception for EIAPs set forth in § 404 of ERISA. *See Smith v. Delta Air Lines, Inc.,* 422 F. Supp. 2d 1310, 1329-30

(N.D. Ga. 2006) (granting motion to dismiss and holding that "[a]t its core," plaintiffs' prudence claim "just amounts to another form of diversification argument"); *In re Coca-Cola Enters., Inc. ERISA Litig.*, No. 1:06-CV-0953, 2007 WL 1810211, at *9 (N.D. Ga. June 20, 2007) (attached hereto as Exhibit 2).

Where, as here, "Congress has resolved competing concerns within ERISA, '[courts should] not attempt to adjust the balance … that the text adopted by Congress has struck.'" *McKesson*, 391 F. Supp. 2d at 828 (quoting *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 263 (1993)). Plaintiffs' claims amount to nothing less than a broadside attack on congressional efforts to promote employee ownership of employer stock, as expressed in the ERISA statute. (*See* Complaint ¶ 118 ("company stock is a particularly risky and volatile investment, even in the absence of company misconduct"). *See also* Complaint at ¶¶ 62-63, 66.) Under ERISA § 404(a)(2), the Complaint must be dismissed in its entirety because all of the counts derive from an alleged failure of Defendants to dump the Plan's Dell stock – something Defendants had no legal duty to do and that by doing so would have threatened the goal of ERISA § 404(a)(2).

B. Investment In Dell Stock Was Prudent.

1. Dell Fiduciaries Are Entitled To At Least A Presumption Of Prudence.

Not all courts have concluded that the plain language of ERISA § 404(a)(2) described above acts as a complete bar to prudence claims based on a failure to sell company stock held by a plan. These courts, led by the Third Circuit in *Moench v. Robertson*, have adopted a rebuttable presumption in favor of a fiduciary's investment in company stock. 62 F.3d at 571 (holding that a fiduciary "who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision"). *See also Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995) (adopting the *Moench* approach). Recently, the Fifth Circuit referred to the rebuttable presumption standard described in *Moench* with approval:

> The Third Circuit wisely balanced the competing policies of ERISA fiduciary duties with statutory exemptions to those duties crafted by Congress to encourage employees' investments in their companies' stocks. *See Moench v. Robertson*, 62 F.3d 553, 568-73 (3d Cir. 1995). The *Moench* standard was adopted by the Sixth Circuit, *see Kuper v. Iovenko*, 66 F.3d 1447, 1458-59 (6th Cir. 1995), and favorably commented on by the Ninth Circuit, *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1097-98 (9th Cir. 2004).

Langbecker v. Elec. Data Sys. Corp., 476 F.3d 299, 309 n.19 (5th Cir. 2007) (dictum).

According to those courts, Plaintiffs must plead facts that, if true, would show that the Dell fiduciaries abused their discretion by investing in Dell stock. *Moench*, 62 F.3d at 571. In order to show this abuse of discretion, plaintiffs must allege a "precipitous decline" in the price of Dell stock, plus knowledge on the part of plan fiduciaries of other extreme facts that courts have variously described as "dire circumstances," serious questions of the company's "viability as a going concern," the company's "impending collapse," or a genuine risk of insider wrongdoing (for the sake of brevity, these events are generally referred to herein as "extreme circumstances").[14] *Id.* at 572.

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[14] For purposes of this Motion, it is not necessary for the Court to determine whether "viability as a going concern" or "impending collapse" is necessary to overcome the presumption of prudence (Defendants believe the answer is "yes"). Plaintiffs fail to allege any precipitous price decline or any circumstance even close to the extreme circumstances described in the case law.

Unless these factors are shown, Plaintiffs cannot overcome the presumption and the prudence claim fails as a matter of law. *See Wright*, 360 F.3d at 1098 (affirming grant of fiduciary's Rule 12(b)(6) motion to dismiss where plaintiffs failed to overcome presumption of prudence because case did "not present a situation where a company's financial situation is seriously deteriorating and there is a genuine risk of insider self-dealing"); *In re Duke Energy ERISA Litig.*, 281 F. Supp. 2d 786, 795 (W.D.N.C. 2003) (holding that prudence claim "fails as a matter of law" because defendant "is a solid, viable company, far from 'impending collapse,' and not in 'dire circumstances'"). Even where the employer stock price has collapsed (not alleged here), plaintiffs must also show misconduct on the part of the Plan's fiduciaries or other extreme circumstances (again, not alleged). *Smith*, 422 F. Supp. 2d at 1331 ("*in addition to a precipitous stock decline*, *Moench* requires that the fiduciaries have knowledge of impending collapse or, as other courts have held, have knowledge of some other impropriety such as misrepresentation, fraud, or accounting irregularities" (emphasis added)).

The Third Circuit recently affirmed a motion to dismiss "artificial inflation" and "stock drop" claims where plaintiffs had ignored published reports that the company was not in deteriorating financial circumstances but was, instead, like Dell, profitable throughout the period. *Avaya,* 503 F.3d at 349. The published reports showing that Dell remained profitable during the Class Period are ignored in Plaintiffs' Amended Complaint. Instead, the stock drop claim teeters on a thin factual reed – because Dell has admitted it overstated its income by $92 million (during a period when it generated over $12 billion in net income),[15] Plaintiffs assert that investing in Dell stock was per se imprudent. (Complaint ¶ 64.) Plaintiffs' imprudence claim cannot be reconciled with Dell's consistent profitability and relatively stable stock price. "[M]ere stock fluctuations, even those that trend downward significantly, are insufficient to establish the requisite imprudence to rebut the *Moench* presumption …. We … see no reason to allow this case to proceed to discovery when, even if the allegations are proven true, Edgar cannot establish that defendants abused their discretion." *Avaya,* 503 F.3d at 349 (citing *Wright*, 360 F.3d at 1099).

2. Even Under A Rebuttable Presumption Standard, Plaintiffs Have Failed To State A Claim.

Instead of alleging that Dell suffered a precipitous stock price decline as required, Plaintiffs make a materially different allegation: that the Plan and Plan participants were harmed due to financial reporting mistakes that led to a temporary decline in the price of Dell stock. These claims make no sense when viewed in the context of Plaintiffs' own alleged Class Period. On May 16, 2002, the day Plaintiffs allege the Class Period began, Dell stock closed at $27.85 a share. On October 31, 2007, the day after Dell released to the public its restated financials, Dell stock climbed to $30.60.[16] (Chart of Dell Stock Prices at 1 (attached hereto as Exhibit 3).) On November 29, 2007, the day Plaintiffs filed the Complaint, Dell stock closed at $28.14, which is also 29¢ higher than the day the Class

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[15] *See* Dell Inc., Annual Report (Fork 10-K), at 22, 108 (Oct. 30, 2007) (excerpts attached hereto as Exhibit 1).

[16] The Court may take judicial notice of a company's stock price without converting a motion to dismiss into a motion for summary judgment. *In re Administaff, Inc. Sec. Litig.*, No. Civ. A. H-03-2082, 2006 WL 846378, at *1 n.1 (S.D. Tex. Mar. 30, 2006) (attached hereto as Exhibit 4).

Period began. (*Id.*) During portions of the Class Period, the price of Dell stock was even higher, reaching a peak of approximately $42 in December 2004.[17] (*Id.* at 15.) Although the price of the stock has decreased somewhat over the last month (closing at $24.89 on December 20, 2007), neither *Moench*, *Kuper* nor *Wright* – nor any other decision of which Defendants are aware – hold that this type of stock price history is sufficient to rebut the ERISA statute's presumption of prudence.

The Circuit Courts of Appeals' decisions confronting this issue have ruled that a fiduciary has a duty to sell employer stock only where the fiduciary knows the employer faces imminent collapse or where the employer is experiencing a serious deterioration of its financial circumstances or other extreme circumstances. In *Moench*, a drop in the price of company stock from $18.25 to less than $.25 per share (a 99% decline) was not, by itself, enough to overcome the presumption of prudence. 62 F.3d at 557. Similarly, in *Kuper*, an 80% decline in value from $50 per share to $10 per share was rejected as insufficient. 66 F.3d at 1451, 1459-60. The Ninth Circuit in *Wright*, in affirming the dismissal of a complaint, held plaintiffs failed to show that the defendant fiduciaries breached their duty of prudence by failing to allow plan participants to sell company stock when its price increased from $23.44 per share to $33.89 per share and then declined by roughly 75% to $7.94 per

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[17] Had Defendants divested the Plan of Dell stock at the beginning of the Class Period as Plaintiffs suggest, Defendants likely would have faced claims for breach of fiduciary duty brought by Plan participants claiming that Defendants' caution deprived them of the opportunity to take advantage of this high share price. *See Moench*, 62 F.3d at 571-72 (noting that "[i]n determining whether the plaintiff has overcome the presumption [of prudence], the courts must recognize that if the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer's securities, it may face liability for that caution, particularly if the employer's securities thrive").

share. 360 F.3d at 1095-96, 1099. In *Avaya*, the Third Circuit also affirmed the dismissal of a complaint, finding no fiduciary breach where employer stock price fell by 25%, from $10.69 to $8.01, in one day. 503 F.3d at 348-49.

Where a plaintiff fails to show that the company is on the verge of collapse or that its financial situation is seriously deteriorating, numerous district courts have ruled that even severe declines in employer stock prices are not enough to show an abuse of discretion. *See, e.g., Smith*, 422 F. Supp. 2d at 1314, 1334 (rejecting claim based on 92% decline); *In re Syncor ERISA Litig.*, 410 F. Supp. 2d 904, 910-11 (C.D. Cal. 2006) (rejecting claim based on massive decline, including two-day decline of 50%); *Pedraza*, 456 F. Supp. 2d at 1275-76 (rejecting a claim based on a 38% price decline); *Nelson v. Ipalco Enters., Inc.*, 480 F. Supp. 2d 1061, 1064, 1097 (S.D. Ind. 2007) (rejecting a claim based on more than 90% decline in stock price and stating, "the defendants probably would have violated their fiduciary duty to comply with the terms of the Plan itself if they had tried to eliminate the option of investing in [Company] stock."); *McKesson*, 391 F. Supp. 2d at 818, 830-33 (rejecting claim based on more than 70% decline); *Duke Energy*, 281 F. Supp. 2d at 794-95 (rejecting claim based on 55.5% decline); *Steinman v. Hicks*, 252 F. Supp. 2d 746, 750, 757-60 (C.D. Ill. 2003), *aff'd*, 352 F.3d 1101 (7th Cir. 2003) (rejecting claim based on more than 25% decline).

The fact that a public company's stock price rises provides no guarantee that the price will not subsequently fall. The Fifth Circuit recently vacated a class certification order in an ERISA case involving a temporary 53% decline (from $36.46 to $17.20) in the price of employer stock. *Langbecker*, 476 F.3d at 304. The Court of Appeals in *Langbecker* seriously questioned the validity of plaintiffs' temporary stock drop claims:

> In this case, however, the description and indeed existence of a Plan-wide fiduciary breach are elusive at this preliminary stage of the case. The key contention is that the fiduciaries "knew" EDS stock was too risky to be offered or allowed as an investment by any Participant (or the vast bulk of them) in the 401(k) Plan during the period in question. This contention challenges the fiduciaries' judgment that EDS was or remained a prudent investment for the Plan to offer. Hindsight is easy in a case like that of WorldCom, a company so infected by over-extension and fraud that it collapsed, and its stock became worthless. EDS, despite its alleged failings, is not in that category. From the facts adduced at the class determination stage, it is far from clear that EDS stock became too risky to be a permissible 401(k) offering or the basis for the employer-matching contribution. Thousands of Plan Participants continued to purchase EDS stock regularly after the company's adverse disclosures and after the price dropped. Thousands held on to their EDS stock rather than sell. The stock price has slowly but steadily rebounded. Given these facts, plus the long-term horizon of retirement investing and the favored status Congress has granted to employee stock investments in their own companies, ascribing a Plan-wide fiduciary failure to Appellants seems fraught with uncertainty.

Id. at 308 (footnotes omitted).

Plaintiffs are arguing, in hindsight, that Dell stock was an imprudent investment as of the first day of the alleged Class Period, May 16, 2006, and that Defendants should have divested the Plan of its Dell stock holdings at that time. The *Moench* standard does not require fiduciaries to diversify company stock holdings before or after each "major corporate development … [i]t merely requires fiduciaries to act reasonably." *Wright*, 360 F.3d at 1099. Plaintiffs' allegations simply do "not present a situation where a company's financial situation is seriously deteriorating and there is a genuine risk of insider self-dealing" which could call into question the fiduciary propriety of continued investment in Dell stock. *Id.* at 1098 (citing *Moench*, 62 F.3d at 572). Neither a "precipitous decline" in the price of Dell stock nor Defendants' knowledge of Dell's "impending collapse" is described in the

Complaint. To the contrary, the facts recited and incorporated in the Complaint show substantial growth in Dell's business during the Class Period.

The price of Dell stock barely moved in the wake of the public announcements relating to its financial accounting problems. After Dell filed its August 17, 2006 8-K report in which it "revealed that the SEC had begun investigating its revenue recognition practices and other accounting and financial reporting," (Complaint ¶ 74), Dell's stock price barely budged the next day, closing at $22.16 (down from $22.80), and slowly increased thereafter. (Chart of Dell Stock Prices at 7 (Exhibit 3).) By the close of calendar 2006, Dell's share price stood at $25.09. (*Id.* at 5.) Indeed, the day after Dell released its restated financials on October 30, 2007, its stock price rose to $30.60. (*Id.* at 1.)

Given that the price of Dell stock has not lost any significant value during the Class Period – and indeed has recently traded at prices above the start of the Class Period – Plaintiffs' claim that Dell stock was an imprudent Plan investment makes no sense. A $92 million reduction in net income during a period in which it generated over $12 billion in net income was not viewed by the market as a business-destroying event. The Plan's fiduciaries had no factual basis on which to conclude that a "precipitous decline" in the price of Dell stock was about to occur. The Complaint never suggests that a precipitous decline in the price of Dell stock was imminent nor has such a decline occurred. Where the court is faced with facts showing the price of company stock has not significantly declined and showing the company's profitability remains robust, no claim for imprudence will lie. *Avaya*, 503 F.3d at 348-49. Thus, the Prudence Claim fails as a matter of law.

3. The Complaint Also Fails To Allege Any Other "Changed Circumstances" That Show Retaining The Dell Stock Fund Was An Abuse Of Discretion.

The Third Circuit in *Avaya* noted that the presumption of prudence could be rebutted by showing that the fiduciaries could not reasonably have believed "that continued adherence to the ESOP's direction was in keeping with the settlor's expectation of how a prudent trustee would operate." *Avaya*, 503 F.3d at 348. This showing could be made through evidence that continued investment in employer stock would "defeat or substantially impair" the trust's purpose due to "circumstances not known to the settlor and not anticipated by him."

> In *Moench*, we observed that the plaintiff alleged "that the precipitous decline in the price of [the employer's stock], as well as [defendants'] knowledge of its impending collapse and [their] own conflicted status, changed circumstances to such an extent that [defendants] could effectuate the purposes of the trust only by deviating from the trust's direction or by contracting out investment decisions to an impartial outsider.

Id. (citation omitted).

Not only do Plaintiffs fail to allege that the purported "artificial inflation of profit and revenue growth" ever brought Dell to the brink of financial collapse, *see* Section I.B.2., but also they do not plead any other extreme circumstances that "created the type of dire situation which would require defendants to disobey the terms of the Plan by not offering the … Stock Fund as an investment option." *Avaya*, 503 F.3d at 348. Indeed, the Complaint pleads no facts suggesting that, at any time, the Prudence Defendants had any reason to believe that Dell "was anything other than a viable, strong company with substantial assets," and there is simply no way that Plaintiffs could ever plead or prove facts necessary to show that the Prudence Defendants abused their discretion by failing to sell the Plan's Dell stock. *Duke Energy*, 281 F. Supp. 2d at 795; *see also Avaya,* 503 F.3d at 349.

The Complaint instead focuses on Dell's filing of allegedly misleading financial statements that artificially inflated the Company's profit and revenue growth figures. With one exception, no specifics are described. The only specific instance given of Dell's supposed misconduct is its announcement on August 14, 2006, of a battery recall for laptop computers. (Complaint ¶ 73.) The theory underlying Plaintiffs' Complaint is that the Prudence Defendants, with the benefit of 20/20 hindsight, should have known about the alleged artificial inflation of Dell's profit and revenue growth figures (even though Plaintiffs do not allege that the Prudence Defendants had such knowledge) and immediately sold all of the Plan's Dell stock.

The Complaint itself demonstrates the absurdity of the idea that ERISA fiduciaries have a duty to sell employer stock any time fiduciaries get wind of an event that may have an adverse effect on the plan sponsor's business. Had Defendants sold all of the Plan's Dell stock on May 16, 2002 (the first day of the Class Period), when Dell stock was trading at $27.85 a share, Plaintiffs would have lost the subsequent appreciation amounting to $14.53 per share through December 13, 2004 when the stock closed at $42.38, a 65.71% increase. (Chart of Dell Stock Prices at 15 (Exhibit 3).) In fact, Dell's stock thereafter did not drop below $27.85 until April 21, 2006, when it closed at $27.01. (*Id.* at 9.) As discussed above, one day after it published its restated financials, October 31, 2007, Dell stock closed at $30.60. Given these facts, Plaintiffs' prudence arguments make no sense. Accordingly, allowing this case to proceed to discovery would be a waste of the Court's and the parties' time and resources. *Avaya*, 503 F.3d at 349.

II. Plaintiffs' Remaining Claims Are Derivative Of The Prudence Claim And Fail For The Same Reasons.

Plaintiffs allege that Defendants failed to disclose accurate information to Plan participants (Count II), failed to prudently monitor the other Plan fiduciaries (Count III), and are liable as co-fiduciaries (Count IV). These claims "do not provide independent grounds for relief, but rather depend upon the establishment of an underlying breach of fiduciary duty cognizable under ERISA." *Duke Energy*, 281 F. Supp. 2d at 795. *See also* ERISA § 405(a), 29 U.S.C. § 1105(a) (2006). All three claims are premised on the assumption that Dell stock was an imprudent investment, and the monitoring and co-fiduciary duty defendants should have stepped in and sold the stock if the primary fiduciaries did not. Because, as demonstrated above, Dell stock was not an imprudent investment, there was no underlying breach by the fiduciaries who chose Dell stock as a Plan investment. Consequently, the three derivative claims fail as a matter of law. *See Duke Energy*, 281 F. Supp. 2d at 795; *In re Syncor ERISA Litig.*, 410 F. Supp. 2d at 913.

III. Plaintiffs' Claims Are All Equitable In Nature And Therefore Fail Because The Elements Of Equitable Estoppel Are Not Satisfied.

Courts look to the "substance" of the remedy sought rather than the label placed on that remedy to determine whether the relief requested by a plaintiff for breach of fiduciary duty under ERISA is equitable in nature. *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 255 (1993). In *Varity Corp. v. Howe*, 516 U.S. 489, 492, 515 (1996), the Supreme Court squarely ruled that the remedy for misrepresentation claims under ERISA lies within ERISA

§ 502(a)(3). The Supreme Court has also made clear that claims arising under ERISA § 502(a)(3) are limited to equitable remedies. *See, e.g., Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 212-13, 218 (2002). Accordingly, where – as here – Plaintiffs' fiduciary breach claims are all predicated on allegations that the underlying stock was artificially inflated due to misrepresentations and was therefore imprudent to hold in an ERISA Plan, Plaintiffs must meet the requirements of equitable estoppel in order to seek to enforce those claims.

It is settled law in the Fifth Circuit that to establish a claim for equitable estoppel under ERISA, a plaintiff must show: "(1) a material misrepresentation; (2) reasonable and detrimental reliance upon the representation; and (3) extraordinary circumstances." *Mello v. Sara Lee Corp.*, 431 F.3d 440, 444-45 (5th Cir. 2005). *See also Weir v. Fed. Asset Disposition Ass'n*, 123 F.3d 281, 290 (5th Cir. 1997) (requiring proof of a material misrepresentation, reasonable and detrimental reliance, and extraordinary circumstances in a class action to recover benefits under an equitable estoppel theory alleging misrepresentations about the interpretation and implementation of ERISA-regulated severance plans). ERISA § 409(a) establishes that an action exists to recover losses "resulting from" a breach of fiduciary duty. Thus, the ERISA statute additionally requires that the breach of fiduciary duty be the proximate cause of the losses claimed. *Ferrer*, 484 F.3d at 781 n.21. Because Plaintiffs fail to meet these standards, each of Plaintiffs' claims – all of which assume that Dell stock was artificially inflated – also fail.

First, Plaintiffs have failed to allege individual reliance. In *Ferrer*, the Fifth Circuit recently upheld the dismissal of a complaint raising an ERISA estoppel claim on this basis. *Id.* at 782. The plaintiffs there asserted that Chevron breached its duty as an ERISA plan fiduciary by misrepresenting the eligibility requirements for early retirement benefits through several oral and written communications. *Id.* at 780. The flaw in plaintiffs' complaints in *Ferrer* was that they were "missing the necessary causal link" between the misrepresentations and the plaintiffs' decisions regarding retirement benefits. *Id.* at 782. And, thus the *Ferrer* plaintiffs failed to demonstrate detrimental reliance. *Id.*

Rather than alleging individual reliance here, Plaintiffs simply assert that because the Dell stock in their account was artificially inflated, they are entitled to damages. Plaintiffs' allegations, however, do not state, infer or imply that they ever detrimentally relied on (or even read) the SEC filings containing the allegedly misleading information or traded Dell stock based on this information.[18]

Plaintiffs' contention that they are bringing the failure to disclose claim on behalf of the Plan is irrelevant. As the Fifth Circuit explained in *Langbecker*, "The Plan 'as a whole' is not entitled to recover money damages for breach where an individual participant, suing on his own behalf, could not recover." 476 F.3d at 312. *See also In re Enron Corp. Sec. and ERISA Litig.*, No. MDL 1446, Civ. A. H-01-3913, 2006 WL 1662596, at * 17 (S.D. Tex.

[18] Plaintiffs allege misrepresentations concerning six purported improper business practices: (1) that Dell represented to the public it had industry-leading results, when it was experiencing a significant decline in its profit margins (Complaint at ¶¶ 69-70); (2) that Dell overstated its profits by under-accruing for standard warranty costs (*id.* at ¶ 71); (3) that Dell "masked unfavorable inventory accumulation trends" (*id.* at ¶ 72); (4) that Dell failed to make a timely disclosure regarding a laptop computer battery recall (*id.* at ¶ 73); (5) that Dell lacked appropriate internal controls to ensure the accuracy of its financial reporting (*id.* at ¶¶ 84-85); and (6) that Defendants who knew of these accounting and financial shortcomings failed to disclose these facts to the participants (*id.* at ¶¶ 89-90).

June 7, 2006) (noting in a case seeking plan-wide relief under § 502(a)(2) that, with respect to a misrepresentation claim, reliance "is a matter of individualized proof") (attached hereto as Exhibit 5).

Second, Plaintiffs have not and cannot explain why a $92 million change in reported net income, during a period in which the Company earned over $12 billion in net income, is material.[19] As the Third Circuit explained in *Avaya,* "[i]n the investment context, 'a misrepresentation' is 'material' if 'there was a substantial likelihood that it would have misled a reasonable participant in making an adequately informed decision about whether to place or maintain monies' in a particular fund." *Avaya*, 503 F.3d at 350 (quoting *In Re Unisys Sav. Plan Litig.*, 74 F.3d 420, 442 (3rd Cir. 1996)).[20] Could Plaintiffs reasonably and to their detriment rely on an error of this small magnitude?

[19] Plaintiffs' theory simply ignores the actual economic substance of Dell's restatement. During the 17-quarter period at issue, the restatement reduced earnings by 3¢ per share from the $4.78 per share Dell had previously reported (a 0.6% adjustment). The company also reduced revenue $359 million over this same period from the previously reported $196.2 billion (a less than 0.2% correction). In response to these minor corrections to Dell's financial reports, Dell's stock price *increased* by 80¢ from October 30 to close at $30.60 on October 31, 2007.

[20] The Third Circuit in *Avaya*, 503 F.3d at 350 (citations omitted), further noted:

> [H]ad the *Avaya* defendants "publicly released any adverse information they had prior to the April 2005 announcement, under the 'efficient capital markets hypothesis,' such a disclosure would have resulted in a swift market adjustment." Therefore, as the District Court reasoned, "the Plans would not have been able to sell their Avaya stock holdings at the higher, pre-announcement price, and the Plans would have sustained the same losses they incurred when the Company publicly announced the quarterly results in April 2005." In addition, the District Court observed, had defendants decided to divest the Plans of Avaya stock based on information that was not publicly available, they would have faced potential liability under the securities laws for insider trading.

In *Martinez v. Schlumberger, Ltd.*, the Fifth Circuit adopted a "fact-specific" approach to assessing materiality in ERISA misrepresentation claims. 338 F.3d 407, 428 (5th Cir. 2003). *Martinez* directs courts to consider "whether the employee knew or should have been aware of other information." *Id.* (internal quotations omitted). Did each Plan participant read all of the same disclosures? Did each participant have the same knowledge about investing or investing in Dell stock? In *Avaya*, the Third Circuit found that the disclosures contained in the summary plan description about investment risk defeated plaintiff's misrepresentation claims. 503 F.3d at 350. The same disclosures about Dell stock being a risky and non-diversified investment were made here. Plaintiffs cannot show they were forced to invest in Dell stock nor can they truthfully assert Dell stock was ever promoted as a safe retirement investment. Every Dell Inc. 401(k) Plan Summary Plan Description provided to Plaintiffs contained a prospectus stating any investment in the Dell Stock Fund "involves a high degree of risk." (*See, e.g.*, Complaint Exh. M, 2003 SPD at 30.) As such, their fiduciary breach claims fail to meet the *Martinez* standard.

Third, Plaintiffs have not alleged they are the victims of "extraordinary circumstances" warranting the application of estoppel.

Finally, as in *Ferrer*, Plaintiffs have failed to plead a causal connection between the fiduciaries' alleged misrepresentations and the plaintiffs' alleged losses. 484 F.3d at 782. The Supreme Court in the securities fraud context recognized that the stock losses must result from investors learning the truth regarding the facts related to the prior misrepresentation. *Dura Pharm. Inc. v. Broudo*, 544 U.S. 336, 341-43 (2005) ("causal connection" is required under the PSLRA between a misrepresentation and a loss because stock prices are influenced by a "tangle of factors"). The Supreme Court further noted that:

> [L]ower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price.

Id. at 343. Plaintiffs have utterly failed to identify in their pleadings a loss that is causally connected to any of the alleged misrepresentations.

Because all four of Plaintiffs' claims require a showing of equitable estoppel, the failure to plead the required elements of that claim is fatal to the entire Complaint.

CONCLUSION

For the foregoing reasons, Defendants respectfully request that the Complaint be dismissed with prejudice and that judgment be entered in favor of Defendants.

December 20, 2007

Respectfully submitted,

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