No. 12-751

In The

Supreme Court of the United States

FIFTH THIRD BANCORP, ET AL.,

Petitioners,

v.

JOHN DUDENHOEFFER, ET AL.,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

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BRIEF FOR LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENTS

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INTEREST OF *AMICI CURIAE*

Amici curiae are legal scholars who write and teach about pension and employee benefits law.[1] One of their primary areas of concern is retirement income security under defined contribution plans where, unlike traditional defined benefit plans, (1) no particular level of benefits is promised and (2) the plan participants bear all the investment risk. They are particularly concerned about plans that invest assets in employer securities. The issues in this case are exceptionally important because they potentially affect the retirement income security of millions of plan participants. Unlike the situation in 1974, when ERISA was enacted, most plan participants now have only a defined contribution plan; they do not have a defined benefit plan to provide guaranteed retirement income.

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[1] The parties have filed with the Clerk of the Court blanket letters of consent to the filing of amicus briefs in support of any party. In fulfillment of the requirement of Rule 37.6, *amici* state that no counsel for either party has authored this brief in whole or in part, and that no person or entity, other than *amici* or their counsel, made a monetary contribution to the preparation or submission of this brief.

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Amici hope that their experience and expertise will assist the Court in its consideration of the important questions this case presents.

SUMMARY OF ARGUMENT

The Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.*, requires a plan fiduciary to

> discharge his duties with respect to a plan solely in the interest of the 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.

ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

This case concerns the application of that statutory requirement to fiduciaries of plans that invest in the sponsoring employer's securities.

In 1995, the Court of Appeals for the Third Circuit held that fiduciaries of ESOPs (employee stock ownership plans) are generally entitled to a presumption that investment in or retention of employer securities satisfies the ERISA standard of prudence (the "*Moench* presumption"). *See Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), *reh'g denied*, 1995 U.S. App. LEXIS 26141 (3d Cir. 1995), *cert. denied*, 516 U.S. 1115 (1996). Six other courts of appeals have adopted some permutation of the *Moench* presumption, but these courts are divided as to the strength of the presumption, the evidence required to overcome the presumption, and whether the presumption applies on a motion to dismiss.

The *Moench* presumption should not be applied to *any* stage of the proceedings, let alone to the pleading stage. The presumption is neither consistent with the statutory language nor necessary to resolve any perceived conflict between the central purpose of ERISA and encouragement of employee ownership. The presumption also undermines the primary goal of ERISA as outlined in Section 2 of the Act (29 U.S.C. § 1001): the protection of retirement plan participants

and beneficiaries. Additionally, the presumption ignores important differences between ERISA and private trust law.

Rather than being allowed a presumption of prudent investment, ERISA fiduciaries of defined contribution plans with employer stock should be subject to the standard found in the statute – the "Prudent Man" standard (also known as the "Prudent Person" standard). Although ERISA provides an exception for the inherent nondiversification risk associated with investment in employer stock, it provides no exception for the prudential concerns raised when the fiduciary should be aware that the *specific company's securities* raise a *specific investment risk* – which was the exact claim made by the Respondents in this case.

Defined contribution retirement plans cover millions of plan participants and beneficiaries and hold billions of dollars in sponsoring employer securities. The answers to the question presented will have a significant effect on the retirement security of all participants and beneficiaries of such plans.

ARGUMENT

I. The *Moench* Presumption Is Flatly Inconsistent with ERISA's Statutory Language, and Is Not Required to Balance the Different Provisions of ERISA.

A. The Statute Makes Clear that Fiduciaries Are Subject to the Prudent Person Standard, Not a Presumption of Prudent Investment.

In creating the "*Moench* presumption," the courts of appeals have simply disregarded an express, unambiguous requirement of ERISA – that a fiduciary is bound by the "prudent person" rule, according to which the fiduciary must act "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." ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

Even were the legislative history crystal clear that Congress "intended" something like a *Moench* presumption to apply, the courts would not be free, under standard principles of statutory construction, to disregard the express language of the Act.[2] But in

[2] *I.N.S. v. Cardoza-Fonseca*, 480 U.S. 421, 452-53 (1987) (Scalia, J., concurring) ("Judges interpret laws rather than reconstruct legislators' intentions. Where the language of those laws is clear, we are not free to replace it with an unenacted legislative intent."); *Oncale v. Sundowner Offshore Servs., Inc.*, 523

(Continued on following page)

fact, as demonstrated below, there is *no* legislative history that suggests a congressional preference for the *Moench* presumption. To the contrary, all available evidence suggests Congress intended that plans that invest in the sponsoring employer's securities – like every other plan subject to ERISA – be subject to the prudence requirement.

It is true that for "eligible individual account plans" (EIAPs) like the plan here at issue, Congress relaxed the statutory investment-diversification requirement that would otherwise apply under ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C), as follows: The "diversification requirement . . . and the prudence requirement (*only to the extent that it requires diversification*) . . . is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities. . . ." ERISA § 404(a)(1)(C), (a)(2), 29 U.S.C. § 1104(a)(1)(C), (a)(2) (emphasis added).[3] The italicized language removes whatever doubt might have remained that *aside from diversification*, Congress meant for the usual prudence standard to apply to plans such as that presented here, as it does to all other plans.

U.S. 75, 79 (1988) ("[I]t is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed.").

[3] Subsequent legislation requires some degree of diversification, even in employee stock ownership plans (ESOPs). *See, e.g.*, 26 U.S.C. § 401(a)(28), (a)(35); ERISA § 204(j), 29 U.S.C. § 1054(j).

This exception does not present a statutory conflict, a "latent ambiguity" which courts might be forced to resolve by reference to drafter intent. Rather, as expanded in Part II below, the statute can be applied exactly as written: by requiring fiduciaries of EIAPs to adhere to a standard of prudence except to the extent prudence would require diversification. Stated another way, a fiduciary is guilty of having violated this requirement only if the fiduciary acted imprudently, *without regard to whatever imprudence inheres in the mere fact of nondiversification of assets*.

The standard as so applied would perfectly reflect the statutory language (and, as demonstrated below, congressional priorities). Instead, however, most courts of appeals have substituted a blanket *presumption* of prudence – a judicial construction completely at odds with the language of the statute, and which creates a barrier to ERISA litigants that not a shred of evidence exists to suggest Congress ever contemplated. The courts' departure from the statutory language extends as far as the imposition of a requirement that plaintiffs must allege a "dire situation," evidence that implicates the company's viability as an ongoing concern, or "evidence that the company is on the brink of collapse," and furthermore that "*[i]t will not be enough for plaintiffs to prove that the company's stock was not a 'prudent' investment*."[4] Such an extraordinary judicial disregard of express

[4] *Quan v. Computer Scis. Corp.*, 623 F.3d 870, 882 (9th Cir. 2010) (emphasis added).

statutory language would be shocking even in the absence of ERISA's stated purpose of protecting plan participants and beneficiaries.

B. "Fostering Employee Ownership" Is Not a Paramount Goal of ERISA.

1. The Statute Does Not Show "Fostering Employee Ownership" to Be Paramount.

Throughout their briefs, Petitioners and their *amici* assert that fostering employee ownership is a paramount goal under ERISA.[5]

The "protection of employee retirement savings" was the overarching central goal of ERISA. It is a mistake to view encouragement of employee ownership as having the same priority as the protection of employee retirement savings.

The statute itself does not permit this conclusion. Relative to protecting employee retirement savings, encouragement of employee ownership was an afterthought, one of many subordinate congressional policies that found their way into the statute.

ERISA provides that:

> It is hereby declared to be the policy of this [Act] to protect . . . the interests of participants

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[5] *See, e.g.*, Petitioners' Br. 4-7, 25-30, 35-40.

> 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.

ERISA § 2(b), 29 U.S.C. § 1001(b).

This statement of purpose is found in the statute itself. It is difficult to imagine how Congress could have expressed more clearly the Act's overriding purpose. There is no similar statement concerning the importance of encouraging employee ownership. Contrary to Petitioners' and their *amici's* arguments, the protection of the interests of participants and beneficiaries is more important than encouraging employee ownership. Congress enacted ERISA to "[protect] employee pensions and other benefits." *Varity Corp. v. Howe*, 516 U.S. 489, 496 (1996).[6]

2. Retirement Security, Not Employee Ownership, Is the Dominant Objective of Congressional Savings Policy.

Petitioners and their *amici* cite to legislative history – in particular the Tax Reform Act of 1976 –

[6] *See* Paul M. Secunda, *Sorry, No Remedy: Intersectionality and the Grand Irony of ERISA*, 61 HASTINGS L.J. 131, 133-36 (2009) (discussing that courts have mistakenly elevated secondary purposes of ERISA over its primary one – protecting employees' retirement and welfare benefits).

in support of their argument of congressional support of encouraging employee ownership.[7] Yet their citations are taken out of context. Taking the long view of congressional savings policy, retirement security emerges as the dominant objective.

The Tax Reform Act of 1976 discusses Congress's desire to "encourage employee stock plans" and adds that "Congress is deeply concerned that the objectives sought by [ERISA and other laws] will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans." Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1520 (1976).

That statement of congressional "concern" does not purport to – and it does not – amend or dilute any provision of ERISA, much less the fiduciary duty provision that is central to the statutory scheme. As noted above, when Congress wanted to make exceptions for ESOPs, it did so explicitly. *See, e.g.*, ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2) (diversification).

Congress's "concern" was really a reaction to proposed Treasury and Labor Department regulations on prohibited transactions that would have made it impossible for ESOPs to be established and function effectively. S. Rep. No. 94-1236, at 539 (1976). The conference report itemizes the specific parts of the proposed regulations with which Congress was "concerned," which generally have to do with issues such

[7] *See, e.g.,* Petitioners' Br. 35-40.

as loans to ESOPs, options on ESOP stock, voting rights and dividend restrictions applicable to ESOP stock. *See id*. at 540-42. None has anything to do whatsoever with ERISA's fiduciary duties.

More importantly, section 803(h) of the Tax Reform Act of 1976 was enacted as a substitute for a provision in the original Senate bill that would have exempted ESOPs from all of ERISA Title I – including all fiduciary responsibility rules – by simply declaring that ESOPs are not "employee benefit plans" and are thus not subject to ERISA at all.[8]

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[8] *See* Peter J. Wiedenbeck, *Trust Variation and ERISA's Misbegotten "Presumption of Prudence,"* forthcoming TAX NOTES (Mar. 2014) [hereinafter Wiedenbeck, *Trust Variation*] (manuscript at 19-20 & n.87), submitted to this Court by Respondents pursuant to Supreme Court Rule 32.3 on February 26, 2014. The Senate version of H.R. 10612, 94th Cong. § 804(g)(1), as reported July 10, 1976, with amendments, provided:

> An employee stock ownership plan which satisfies the requirements of paragraph (2)(A) [a cross-reference to the tax law definition in I.R.C. § 4975(e)(7)] shall not be considered to be an employee benefit, employee welfare benefit, or employee pension benefit plan (within the meaning of paragraph (2)(D)) under any law or rule of law of the United States other than [the Internal Revenue Code or the Tax Reduction Act of 1975]. * * *

S. Rep. No. 94-938(II), at 6 (1976) reports that the Finance Committee deleted a provision previously agreed to (above) that "would end the treatment of ESOP's as employee pension or welfare plans under Federal law (other than tax law)." *Id*. at 74 (same).

Petitioners and their *amici* overlook that as far as one can tell, all legislation supporting ESOPs was promoted by one Senator – Senator Russell Long, chairman of the Senate Finance Committee. While under Senator Long's Finance Committee leadership additional ESOP tax incentives were added in the years following ERISA's passage, once he retired in 1986, the flow of legislation waned.[9]

In 1986, the early distribution penalty was extended to apply to all qualified plans – including ESOPs – indicating that retirement income security should serve as the prime directive for EIAPs.[10] Also in 1986, the remaining ESOP tax credit was phased out of the code.[11] In 1989, the estate tax deduction on sales to ESOPs was repealed.[12] In 1996, the 50 percent income exclusion for interest income on ESOP loans was eliminated.[13]

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[9] For a detailed account of Senator Russell Long and his conversion to the gospel of employee stock ownership, *see* Wiedenbeck, *Trust Variation*, *supra* (manuscript at 16-21); Andrew W. Stumpff, *Fifty Years of Utopia: A Half-Century After Louis Kelso's The Capitalist Manifesto, A Look Back at the Weird History of the ESOP*, 62 TAX LAW. 419, 425-26 (2009).

[10] Wiedenbeck, *Trust Variation*, *supra* (manuscript at 20-21).

[11] Tax Reform Act of 1986, Pub. L. No. 99-514, § 1171, 100 Stat. 2085, 2513 (1986).

[12] *See* Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 7304, 103 Stat. 2106, 2352-53 (1989).

[13] *See* Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1602, 110 Stat. 1755, 1833-34 (1996).

Prior to the 2006 Pension Protection Act ("PPA") amendments to ERISA, plans could require employer match shares (but not employee contributions) to be kept in employer stock until the participant terminated employment or reached a plan-stated age. The PPA amended ERISA to require that a defined contribution plan holding publicly traded employer stock must allow a participant to divest those securities after three years of service and invest the proceeds in other plan options. ERISA § 204(j), § 401(a)(35).

Even if a consistently expressed prior congressional policy in favor of employee ownership could be discerned (which it cannot), and even if it were generally permissible for the courts to take such a policy into account to override express statutory language (which it is not), *amici* believe it worth observing that the rationales that might have supported such a policy have since been discredited. When Congress enacted ERISA, most workers fortunate enough to be covered by a retirement plan participated in a traditional defined benefit pension plan. In the last two decades, there has been a dramatic shift from defined benefit plans to defined contribution plans. As this Court noted in *LaRue v. DeWolff, Boberg & Associates, Inc.*, 401(k) plans like the plan at issue here have become – aside from Social Security – the primary vehicle for providing retirement income in America. 552 U.S. 248, 255 & n.5 (2008).

The problems arising from the shift of investment risk from employers (in defined benefit plans) to employees (in defined contribution plans) are

exacerbated when the investments in the defined contribution plan are in company stock. An employee is already massively under-diversified with respect to his or her human capital tied up with the employer, which is inextricably exposed to the business risks of his employer. The last thing that any employee should do is to magnify the intrinsic under-diversification of the employment relationship, by taking his or her diversifiable investment capital and tying that as well to the fate of the employer.[14]

The collapse of Enron raised the national awareness of the problem of employee ownership of a company. Enron Corp.'s 401(k) plan was typical of the pre-PPA genre. Enron matched 50 percent of all participant pre-tax contributions, up to a maximum of 6 percent of base pay, entirely in Enron stock. The plan required the participant to retain the match shares until age fifty. At year-end 2000, about 60 percent of the Enron plan's assets were invested in the Enron stock fund. The market price of a share of Enron stock declined from a high of $88 in September 2000 to less than a dollar in late 2001. Thus, when Enron collapsed, the employees of Enron lost their retirement savings at the same time they lost their jobs.

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[14] *See* John H. Langbein, Testimony to S. Comm. on Governmental Affairs, Jan. 24, 2002, *reprinted as* "What's Wrong with Employer Stock Pension Plans," in *Enron and Other Corporate Fiascos: The Corporate Scandal Reader* 487 (Nancy B. Rapoport & Bala G. Dharan eds., 2d ed. 2009).

As noted by the Seventh Circuit Court of Appeals:

> The time may have come to rethink the concept of an ESOP, a seemingly inefficient method of wealth accumulation by employees because of the underdiversification to which it conduces. . . . The tax advantages of the form do not represent a social benefit, but merely a shift of tax burdens to other taxpayers. Nor are we aware of an argument for subsidizing the ESOP form, as the tax law does, rather than letting the market decide whether it has economic advantages over alternative forms of business structure. As for the notion that having a stake in one's employer will induce one to be more productive, the evidence for such an effect . . . is weak and makes no theoretical sense. An employee has no incentive to work harder just because he owns stock in his employer, since his efforts, unless he is a senior executive, are unlikely to move the price of the stock.

Summers v. State St. Bank & Trust Co., 453 F.3d 404, 411-12 (7th Cir. 2006) (citations omitted).

3. The *Moench* Presumption Undermines Participants' Rights Under ERISA.

Plan participants alleging a breach of fiduciary duty face a significant burden of proof. They must prove (1) that the fiduciary had a particular duty; (2) that the fiduciary breached that duty; and (3) that they suffered loss as a result of that breach.

The *Moench* court heightened this burden for ESOP participants, holding that "in the first instance, an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision." 62 F.3d at 571.

This presumption was created out of thin air by the Third Circuit. It contradicts the words of the statute, and neither the Third Circuit nor any successor court has identified a shred of evidence that Congress contemplated such a result.

Even if abuse of discretion were the appropriate standard of review, it has been misapplied by the courts of appeals through the imposition of additional requirements, as discussed in Part III.B below. Adding requirements to the abuse of discretion standard in company stock cases has resulted in plaintiffs' burden being very difficult, if not impossible (in particular on a motion to dismiss as discussed *infra* Section III.A), to satisfy.

Certain of Petitioners' *amici* argue that the presumption is necessary to "weed out meritless litigation." This position, however, ignores that a district court judge has all the tools necessary to weed out meritless cases under Fed. R. Civ. P. 12(b)(6) without resort to a presumption, in particular since this Court ruled in *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007). As noted above, plan participants alleging a breach of fiduciary duty already face a significant burden of proof. If a plaintiff fails to plead facts making

plausible the conclusion that the fiduciary failed to comply with the prudent person standard, then the case should be dismissed under Rule 12(b)(6). That course by the lower courts would be far more consistent with the cardinal principles of judicial restraint.

4. The Diversification Exemption Does Not Exempt Fiduciaries from the Prudent Person Standard.

In support of their argument that Congress elevated employee stock ownership to paramount importance under the statute, Petitioners, their *amici*, and certain appellate courts[15] cite the statutory exemption from the diversification requirement. As discussed below, this position is not supported by either the text of ERISA or ERISA's legislative history.

Although prudent investment ordinarily requires diversification,[16] the need to diversify is inherently in tension with employee stock ownership plans, which concentrate the plan's assets in the employer's stock. Congress instructed precisely what to do about that tension:

> In the case of an eligible individual account plan . . . , the diversification requirement of

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[15] *See, e.g.*, *In re Citigroup ERISA Litig.*, 662 F.3d 128, 137 (2d Cir. 2011).

[16] *See*, *e.g.*, Restatement (Third) of Trusts § 90(b) (2007); Uniform Prudent Investor Act § 3 (1994).

> [Section 1104(a)(1)(C)] and the prudence requirement (only to the extent that it requires diversification) of [Section 1104(a)(1)(B)] is not violated by acquisition or holding of . . . qualifying employer securities.

ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2).

Section 1104(a)(2) thus makes clear that fiduciaries may invest in qualified employer securities without fearing liability for failing to diversify. But Section 1104(a)(2) also makes clear that Congress intended no further diminution of ERISA's fiduciary duties in order to encourage employee stock ownership. ERISA's requirement that fiduciaries act prudently is relaxed "only to the extent that it requires diversification." ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2). Insofar as acquiring or holding qualified employer securities is imprudent *for any reason other than the need to diversify* – such as when the employer stock is significantly overvalued – the unqualified "care, skill, prudence, and diligence" provision retains full force; it continues to mandate that the fiduciary take appropriate action to protect participants from imprudent investments. To hold otherwise would violate the maxim *expressio unius est exclusio alterius*. *See Vasquez v. Cargill, Inc.*, 509 F. Supp. 2d 903 (C.D. Cal. 2007) (applying maxim in an ERISA fiduciary case).

Turning to legislative history, the ERISA legislative history gives two reasons for the diversification exemption. First, it was common for such plans to invest in employer securities prior to ERISA. Second,

profit-sharing and stock bonus plans (including ESOPs) were viewed as having a different purpose than traditional pension plans.

ERISA's committee reports confirm this rationale. The pre-ERISA Treasury regulations describe the purpose of a profit-sharing plan as enabling employees or their beneficiaries to participate in the employer's profits. *See* Treas. Reg. § 1.401-1(a)(2)(ii), 21 Fed. Reg. 7276 (Sept. 25, 1956). The Senate Finance Committee Report on the bill that (with amendments) became ERISA states that "[s]ince profit-sharing and stock-bonus plans are intended to a large extent to serve as an incentive to employees by allowing them to participate in the profits of the company, the committee bill generally places no restriction on the purchase of employer securities by such plans." S. Rep. No. 93-383 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4889, at 4918.

Similarly, the House Conference Committee Report refers to "the special purpose of these individual account plans." H.R. Rep. No. 93-1280 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, at 5097.

Section 401(k) of the Internal Revenue Code, I.R.C. § 401(k), was enacted in 1978, four years after ERISA. *See* Pub. L. No. 95-600, § 135(a), 92 Stat. 2763 (1978). A 401(k) plan is simply a type of defined contribution plan that allows participants to make elective contributions to the plan, which are sometimes matched by the employer. 401(k) plans are marketed by employers to employees as retirement

plans, not as a way to share in the employer's profits, and participants are encouraged to contribute to the plan to enhance their retirement income security. For example, the Plan document for the Fifth Third Bancorp Master Profit Sharing Plan states that "[t]he purposes of the Plan are to provide retirement and other benefits for Participants and their respective beneficiaries." J.A. 284 (Plan, art. 1.2). Accordingly, whatever the situation when ERISA was enacted, the primary purpose of 401(k) plans and other defined contribution plans is now exactly the same as the primary purpose of traditional pension plans: to provide retirement income.

There is no hint in the legislative history that Congress intended the overall prudence requirement – or any requirement, other than diversification – to be altered for individual account or any other plans. To the contrary, in discussing the relationship between the prudence rule and the exemptions for eligible individual account plans, a Senate Committee report stated: "It is emphasized, however, that even with respect to the transactions expressly allowed, the fiduciary's conduct must be consistent with the prudent man standards." S. Rep. No. 93-127 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4838, at 4867. This contradicts any suggestion that any aspect of the prudence rule other than diversification is abrogated by the exemption for eligible individual account plans.

Even several decisions accepting the *Moench* presumption acknowledge that the diversification

exemption does not relieve fiduciaries from compliance with ERISA's general fiduciary requirements. *See*, *e.g.*, *Pfeil v. State St. Bank & Trust Co.*, 671 F.3d 585 (6th Cir. 2012), *reh'g en banc denied,* 2012 U.S. App. LEXIS 6721 (6th Cir. 2012); *In re Syncor ERISA Litig.*, 516 F.3d 1095 (9th Cir. 2008). In *Quan v. Computer Scis. Corp.,* the Court of Appeals for the Ninth Circuit stated:

> 29 U.S.C. § 1104(a)(2) does not exempt fiduciaries [for EIAPs] from the first prong of the prudent man standard, which requires a fiduciary to act with care, skill, prudence, and diligence in any investment the fiduciary chooses. Thus, fiduciaries are required to act "prudently" when determining whether or not to invest, or continue to invest, ERISA plan assets in the plan participants' employer's stock. This is true, even though the duty of prudence may be in "tension" with Congress's expressed preference for plan investment in the employer's stock.

623 F.3d 870, 878-79 (9th Cir. 2010) (citations omitted).

The Third Circuit, however, in creating the *Moench* presumption, wrongly asserted that not to do so "would render meaningless the ERISA provision excepting ESOPs from the duty to diversify."[17] *Moench*

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[17] Petitioners' concern (Petitioners' Br. 17-18) for undercutting the growth of employee stock ownership is not borne out by the statistics. Between 1975 and 2009, the number of such plans

(Continued on following page)

v. Robertson, 62 F.3d 553, 570 (3d Cir. 1995), *reh'g denied*, 1995 U.S. App. LEXIS 26141 (3d Cir. 1995), *cert. denied*, 516 U.S. 1115 (1996). This is not true. The plaintiffs in all the cited cases specifically sought to prove a fiduciary's failure of prudence arising out of some act *other* than failure to diversify. Granting that it is never a *per se* ERISA violation for an EIAP to be invested entirely in employer stock (because of the exception to the diversification requirement), the facts of a particular case might show that a fiduciary had knowledge of specific circumstances that should have caused him or her to divest the plan of that stock, to stop buying or selling the stock, or to take other appropriate actions. However, it is in such cases, where the fiduciary breaches fall squarely within the type of conduct for which ERISA was intended to provide a remedy, that the *Moench* presumption has been applied to prohibit plaintiffs from even having an opportunity to establish those facts. Eliminating the presumption would permit those cases to proceed, while doing nothing to impair fiduciaries' general ability to ignore the diversification requirement for EIAPs.

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grew six fold, the number of participants in them grew over 40 fold, and their assets reached $869 billion. National Center for Employee Ownership, *A Statistical Profile of Employee Ownership* (Jan. 2012), http://www.nceo.org/articles/statistical-profile-employee-ownership. *See* Circuit Judge Chester J. Straub's dissent in *Citigroup*, noting that the absence of the *Moench* presumption before 1995 did not impede the growth of employee ownership. 662 F.3d at 152 (Straub, C.J., concurring in part and dissenting in part).

In sum, ERISA does not create a conflict between the prudence rule and the rules allowing ownership of employer securities by EIAPs. The statute provides a general rule (the prudence rule) and a well-defined and limited exemption from the diversification requirement. There is no question that a fiduciary must always meet ERISA's general fiduciary responsibility rules of prudence and loyalty when managing plan assets. It is perverse for the courts of appeals to have created a presumption that impairs those rules.

C. The Presumption Ignores the Difference Between ERISA Section 404(a)(1)(D) and Traditional Trust Law.

Under traditional trust law, a trustee must act in accordance with the trust documents. *See*, *e.g.*, Uniform Trust Code § 105(b)(2) (2010). Under ERISA, however, this duty is subject to a significant qualification: a fiduciary must act "in accordance with the documents and instruments governing the *plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter*." ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (emphasis added). This Court has interpreted the provision to mean "that trust documents cannot excuse trustees from their duties under ERISA, and that trust documents must generally be construed in light of ERISA's policies." *Cent. States v. Cent. Transp.*, 472 U.S. 559, 568 (1985). This provision transforms the three core fiduciary principles of trust law in ERISA § 404(a)(1)(A)-(C), 29 U.S.C.

§ 1104(a)(1)(A)-(C) (loyalty, prudence and diversification) from default law into mandatory law.

In articulating the *Moench* presumption, the appeals courts have not followed the plain language of the statute.

For example, in *Lanfear v. Home Depot, Inc.*, the Eleventh Circuit ruled:

> Because the purpose of a plan is set by its settlors (those who created it), that is the same thing as saying that a fiduciary abuses his discretion by acting in compliance with the directions of the plan only when the fiduciary could not have reasonably believed that the settlors would have intended for him to do so under the circumstances. That is the test.

679 F.3d 1267, 1281 (11th Cir. 2012); *see also Citigroup,* 662 F.3d at 140 (adopting "intent of settlor test" and quoting Restatement (Second) of Trusts § 227 cmt. g (1959)); *Quan v. Computer Scis. Corp.*, 623 F.3d at 882 (same).

In focusing on the settlor's intent, these courts have essentially ignored ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D). Although this Court has emphasized that it is "guided by principles of trust law" when interpreting ERISA (*Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 111 (1989), citing *Cent. States v. Cent. Transp.,* 472 U.S. at 570, it has also cautioned "that trust law does not tell the entire story. After all, ERISA's standards and procedural

protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection." *Varity Corp. v. Howe*, 516 U.S. at 497. It follows "that the law of trusts often will inform, but will not necessarily determine the outcome of, an effort to interpret ERISA's fiduciary duties." *Id*. This is especially true in cases where the text of ERISA makes a significant departure from traditional trust law.

The reliance on the traditional trust law intent of the settlor principle is inappropriate for three reasons. First, and most important, with respect to the fiduciary duty to follow a trust document, ERISA does not mirror traditional trust law, as explained above. ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).

Second, the automatic assumption that the employer sponsoring the plan is the "settlor" of the pension trust is in error. Anyone who contributes to the fund is a settlor, presumably including employees who make elective deferrals under a 401(k) plan or a similar salary reduction arrangement.[18] Traditional private trusts involve a donative transfer: subject to limited exceptions, the beneficiaries who wish to accept the donor's bounty must follow his or her rules. By contrast, retirement benefits are compensation, earned by the participants, and in many cases are funded predominantly by employee contributions.

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[18] Wiedenbeck, *Trust Variation*, *supra* (manuscript at 5).

The significance of this point is that the expectations or purposes of the employer sponsoring an ESOP or 401(k) should carry no weight once continued investment in employer stock comes to jeopardize workers' retirement savings. Thus, the "purposes of the trust" should be determined by reference to the employee/settlors' understanding of the Plan, not the understanding of the employer/sponsor. Once the employer falls on hard times and the conflicting goals of the plan become salient, an employee will prioritize her interest in a comfortable retirement over employee ownership, and that participant-centered perspective casts a very different light on the "purposes of the trust" than if the sponsoring employer is treated as settlor.[19]

Third, even non-ERISA trust law is moving away from a focus on settlor intent:

> Although the settlor is granted considerable latitude in defining the purposes of the trust, the principle that a trust have a purpose which is for the benefit of its beneficiaries precludes unreasonable restrictions on the use of trust property . . . . [T]he new direction of American trust law is to rebalance the wishes of the settlor with the ownership rights of the beneficiaries. The administration of the trust must, in the end, be for the benefit of the beneficiaries, and their

[19] *Id*. at 6.

> equitable ownership over the trust assets must be respected.

Thomas P. Gallanis, *The New Direction of American Trust Law*, 97 IOWA L. REV. 215, 225-26 (2011). *See also* John H. Langbein, *Mandatory Rules in the Law of Trusts*, 98 NW. U. L. REV. 1105 (2004) (discussing the long-standing but recently reformulated rule that a trust must be for the benefit of its beneficiaries) (*citing* Restatement (Third) of Trusts § 27(2) (2003); "a private trust, its terms, and its administration must be for the benefit of its beneficiaries" and Uniform Trust Code § 105(b)(3) (2010) requiring that "a trust and its terms [shall] be for the benefit of its beneficiaries").

The modern rules on equitable deviation state:

> The court may modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust.[20]

Contrary to Petitioners' position (Petitioners' Br. 30-34), under this approach it is not necessary "that the situation be so serious as to constitute an 'emergency' or to jeopardize the accomplishment of trust purposes."[21] Moreover, deviation "does not require changed circumstances. It is sufficient that the settlor

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[20] Restatement (Third) of Trusts § 66(1) (2003).

[21] *Id*. cmt. a.

was unaware of the circumstances in establishing the terms of the trust."[22] This, of course, displaces the far more restrictive "defeat or substantially impair" standard for administrative deviation under § 167 of the Second Restatement, the rule invoked by *Moench* and propounded by Petitioners. The Uniform Trust Code adopts a similar approach, noting in commentary that: "While it is necessary that there be circumstances not anticipated by the settlor before a court may grant relief . . . the circumstances may have been in existence when the trust was created." Uniform Trust Code § 412 cmt. at 76 (2010).

The cases adopting the *Moench* presumption suggest a scenario in which it will hardly ever be possible for plan participants to challenge an investment in employer stock. The plan sponsor designs a plan in which the fiduciaries are required to invest, and continue the investment, in employer securities. The plan design is a settlor function, so cannot be challenged as a fiduciary breach. The fiduciaries refuse to depart from the terms of the plan, and the courts' restrictive application of section 1104(a)(1)(D) protects them from liability for refusing. A challenge to the prudence of the investment is defeated by the *Moench* presumption. This looks like a back-door attempt at prohibited exculpation. ERISA forbids the trust agreement, plan documents, or other agreements or instruments from "reliev[ing] a fiduciary

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[22] *Id.*

from responsibility or liability" for its duties under ERISA. ERISA § 410(a), 29 U.S.C. § 1110(a).

II. The Appropriate Standard for Reflecting Congress's Decision to Permit Nondiversified Employee Stock Ownership.

Like many of the courts of appeals, Petitioners and their *amici* make much of a perceived "conflict" in ERISA between, on the one hand, the prudence requirement; and, on the other, the express exception to the diversification for plans that invest in employer stock.[23] As noted above, no such conflict exists.

Logically, diversification of assets is a subset of investment prudence – one specific *aspect* of prudent investment behavior, which was singled out for express treatment by Congress under ERISA. Logically also, Congress was able to, and did, relax this subset of the prudence requirement while keeping the rest of that requirement intact. Indeed it is difficult to see any other way to read the statutory provision here in question:

> [The] diversification requirement . . . and the prudence requirement (*only to the extent that it requires diversification*) . . . is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities. . . .

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[23] *See, e.g., Citigroup*, 662 F.3d at 137.

ERISA § 404(a)(1)(C), (a)(2), 29 U.S.C. §§ 1104(a)(1)(C), (a)(2) (emphasis added).

The correct way to interpret this provision is not to read it as creating a wholesale, blanket presumption of compliance with respect to the entirety of the prudence requirement. Rather, the provision asks courts to put the question: Has the fiduciary acted imprudently, *leaving aside any imprudence that inheres in the simple fact of nondiversification?* And it is entirely possible for a fiduciary to have done so: The fiduciary may be aware that *the specific company's securities* raise, currently, a *specific investment risk*. Indeed, that is exactly the claim made by the Respondents in this case. Such knowledge raises a prudential concern entirely apart from the inherent nondiversification concern which characterizes any investment in a single stock, and which was Congress's obvious concern in granting the relief in the above-quoted provision. There is simply no statutory basis for placing a "presumption of compliance" in the way of a claim for relief by a plan participant in these circumstances.

III. If the Court Accepts the Proposition that There Should Be a Presumption, the Presumption Should Not Be as Insurmountable as Suggested by Petitioners and Their *Amici*.

Even if there were a basis for a presumption of prudence in cases challenging the investment of plan assets in sponsoring employer securities (but see

above), the presumption of prudence should not apply at the pleading stage. Moreover, the standard applied by several circuits to overcome the presumption has transformed the presumption into a bar to any meaningful application of ERISA's prudence standard. Finally, the presumption should only apply to standalone ESOPs – not 401(k) plans that contain company stock funds.

A. The *Moench* Presumption Should Not Be Applied on a Motion to Dismiss.

Several Circuits have rejected the Respondents' and the United States' argument that the *Moench* presumption should not apply at the pleading stage. "The 'presumption' is not an evidentiary presumption; it is a standard of review applied to a decision made by an ERISA fiduciary." *Citigroup*, 662 F.3d at 139. *See also Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1281 (11th Cir. 2012); *Edgar v. Avaya, Inc.*, 503 F.3d 340, 349 (3d Cir. 2007); *Kopp v. Klein*, 722 F.3d 327, 339 (5th Cir. 2013); *White v. Marshall & Ilsley Corp.*, 714 F.3d 980, 990-91 (7th Cir. 2013).

The Sixth Circuit, however, disagreed noting that: "a plaintiff need not plead enough facts to overcome the presumption in order to survive a motion to dismiss. . . . [C]ourts should not make factual determinations of their own or weigh evidence when considering a motion to dismiss." *Pfeil*, 671 F.3d at 593 (citations omitted); *accord*, *Dudenhoefer v. Fifth Third Bancorp*, 692 F.3d 410 (6th Cir. 2012) (Pet. App. 11-13).

This Court should follow the Sixth Circuit's approach and hold that the presumption does not apply on a motion to dismiss.

The fundamental problem with using the presumption as a pleading standard is that whether the fiduciaries breached their duty of prudence is a question of fact that is properly decided by the trier of fact on a full factual record, after the completion of discovery. *In re Enron Corp. Sec., Derivative & ERISA Litig.,* 284 F. Supp. 2d 511, 534 n.3 (S.D. Tex. 2003). *See also LaLonde v. Textron, Inc*., 369 F.3d 1, 6-7 (1st Cir. 2004) (expressing hesitance to apply a "hard-and-fast rule" in ERISA fiduciary duty cases, and instead noting the importance of record development of the facts). As noted in Part I.B. above, in the context of discussing why the *Moench* presumption is inappropriate at any stage, the facts of a particular case might show that a fiduciary had knowledge of specific circumstances that should have caused him or her to divest the plan of employer stock. At the very least, it should not apply at the motion to dismiss stage because this deprives plaintiffs of the opportunity to develop those facts. Indeed, *Moench* was decided on the merits, and thus, the implication is that the presumption was not originally intended to create a supplemental pleading requirement. *Moench*, 62 F.3d at 572 (reversing summary judgment for defendants on presumption issue, and remanding to trial court "for further proceedings in which the record may be developed and the case may be judged on the basis of the principles we set forth").

B. Several Courts of Appeals Have Transformed the Presumption into a Bar.

The *Moench* court stated that in "attempting to rebut the presumption, the plaintiff may introduce evidence that 'owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.'" *Moench*, 62 F.3d at 571 (quoting Restatement (Second) of Trusts § 227 cmt. g (1959)).

In a later case, the Third Circuit stated that a plaintiff need not necessarily prove that a company is "on the brink of bankruptcy" but must demonstrate more than possible fraud or corporate wrongdoing in order to rebut the presumption. *Edgar*, 503 F.3d at 349 n.13; *cf. Quan*, 623 F.3d at 879, quoting *In re Syncor ERISA Litig.*, 516 F.3d at 1102 ("there are a 'myriad of circumstances' that could violate the 'prudent man' standard for investment of ERISA plan assets in a company's own stock").

The Second, Third, Fifth, Seventh, Ninth and Eleventh Circuits have said that plaintiffs must allege a "dire situation," evidence that implicates the company's viability as an ongoing concern, or evidence of "a precipitous decline in the employer's stock combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement." *White*, 714 F.3d at 994; *Citigroup*, 662 F.3d at 140; *Edgar*, 503 F.3d at 348-49; *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 254-56 (5th Cir.

2008); *Quan*, 623 F.3d at 882; *Lanfear*, 679 F.3d at 1282. According to the *Quan* court, "*[i]t will not be enough for plaintiffs to prove that the company's stock was not a 'prudent' investment* or that defendants ignored a decline in stock price." *Quan*, 623 F.3d at 882 (emphasis added). It is difficult to imagine a more direct contradiction by a court of a statute.

These courts have effectively invented the "dire situation" standard, in place of the specific standard of ERISA that all fiduciaries act "with the care, skill, prudence, and diligence under the circumstances . . . that a prudent man . . . familiar with such matters would use." ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

In addition to imposing a very onerous burden on plaintiffs, these criteria do not give any guidance to decision makers. As Circuit Judge Straub stated:

> Such arbitrary line-drawing leaves employees wholly unprotected from fiduciaries' careless decisions to invest in employer securities so long as the employer's "situation" is just shy of "dire" – a standard that the majority neglects to define in any meaningful way.
>
> But the duty of prudence does not wax and wane depending on circumstance; ERISA fiduciaries must act prudently at all times, and those who are derelict must be subject to accountability.

Citigroup, 662 F.3d at 147 (Straub, C.J., concurring in part and dissenting in part).

The Sixth Circuit court took a different approach:

> In contrast to our sister circuits, we have not adopted a specific rebuttal standard that requires proof that the company faced a "dire situation," something short of "the brink of bankruptcy" or an "impending collapse." The rebuttal standard adopted in this Circuit, and the one which we are bound to follow, requires a plaintiff to prove that "a prudent fiduciary acting under similar circumstances would have made a different investment decision."

Pfeil, 671 F.3d at 595 (quoting *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995)); *accord*, *Griffin v. Flagstar Bancorp, Inc.*, 492 F. App'x 598, 603-05 (6th Cir. 2012).

The Sixth Circuit further explained in this case:

> This unembellished standard makes sense – not just because it closely tracks the statutory language of § 404(a)(1)(B) – but also because that language imposes identical standards of prudence and loyalty on *all* fiduciaries, including ESOP fiduciaries . . . We are not free to limit the standard set by the statute by imposing conditions not present in the statutory language.

Dudenhoefer, 692 F.3d at 418; Pet. App. 12-13 (emphasis in original).

The "dire situation" standard provides too much protection for fiduciaries at the expense of plan participants. Indeed, the standard articulated by several circuits is essentially irrebuttable. It would immunize fiduciary misconduct concerning company stock in virtually every case; even in *Enron* and *WorldCom*[24] – where the plans were heavily invested in company stock, while the company and its personnel, including fiduciaries, were engaged in criminal conduct that led to the company's collapse and the loss of the plans' entire investment in company stock – the fiduciaries would not be liable for their spectacular misconduct. Should this Court decide to adopt a presumption, the Court should adopt a standard, such as that in the Sixth Circuit, that is less onerous for plan participants.

C. The Presumption Should Not Apply to Company Stock Funds in 401(k) Plans.

Petitioners argue that the presumption should apply to stand-alone ESOPs, as well as 401(k) plans in which the company stock fund is an ESOP. If there is a presumption, it is the view of *amici* that the presumption should only apply to stand-alone ESOPs, and not ESOPs contained within a 401(k) plan.

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[24] *In re Enron Corp. Sec., Derivative & ERISA Litig.*, 284 F. Supp. 2d 511 (S.D. Tex. 2003); *In re WorldCom, Inc., ERISA Litig.*, 263 F. Supp. 2d 745 (S.D.N.Y. 2003).

Petitioners cite to sections of ERISA and snippets from ERISA's legislative history to support their position of a congressional policy of promoting employee stock ownership through ESOPs. Yet, their citations only apply to stand-alone ESOPs, not 401(k) plans.

One of the fundamental reasons for allowing ESOPs – that (allegedly) providing employees with employer stock will increase employee productivity[25] – arguably does not apply to a company stock fund within a 401(k) plan, which is seen primarily as a retirement plan.[26] Further, in a typical 401(k) plan that offers a company stock fund, not all employees will have investments in the employer stock fund, as they would in a true, stand-alone ESOP.

Moreover, certain of petitioners' *amici* would have the presumption of prudence apply to *all* company stock funds within a 401(k) plan, even if the company stock fund is not an ESOP, and even if the plan language does not purportedly "require" the company stock fund.[27] Petitioners do not even support

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[25] *See Summers*, 453 F.3d at 411-12 (discussing the notion that having employer stock will increase productivity is "weak and makes no theoretical sense").

[26] As noted above, the purpose of the Fifth Third Bancorp 401(k) Plan is "to provide retirement and other benefits for participants and their respective beneficiaries." J.A. 284 (Plan, art. 1.2).

[27] *But see* ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D) (requiring a fiduciary to discharge his duties in accordance with the terms of the trust only "insofar as such documents and

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this position and wisely so, as none of petitioners' arguments concerning the congressional policy of promoting employee stock ownership through ESOPs even touches on this argument. Congressional endorsement was of ESOPs which are intended primarily to invest in employer stock, not all 401(k) plans with an employer stock investment option.

CONCLUSION

ERISA's core goal is spelled out in its title: employee retirement income security. Resolution of the issues in this case is enormously important, as it potentially affects the retirement income security of millions of plan participants. The *Moench* presumption finds no support in the statute or legislative history. Also, as applied by certain courts, the presumption gives too much protection to fiduciaries and insufficient protection to participants and beneficiaries.

Thus, the *Moench* presumption should be rejected by the Court and the lower courts instructed to apply a standard of review that adequately protects the rights of participants and beneficiaries under ERISA.

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instruments are consistent" with other ERISA provisions, including the duty of prudence); and ERISA § 410(a), 29 U.S.C. § 1110(a) (stating "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy").

It is the view of *amici* that ERISA fiduciaries should be subject to the standard found in the statute. Prudential concerns are raised – as here – when the fiduciary may be aware that the *specific company's securities* raise a *specific investment risk*.

Even if some presumption is appropriate, it should not be applied at the pleading stage, the "dire circumstances" formulation of the standard should be modified to avoid acting as a bar to any meaningful claim under ERISA's fiduciary standards, and should not apply to 401(k) plans.

For the above stated reasons, the judgment of the Sixth Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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