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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

BRIEF AMICUS CURIAE OF AARP IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE[1]

AARP is a nonpartisan, nonprofit organization with a membership that helps people turn their goals and dreams into real possibilities, strengthens communities and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse. In its efforts to foster the economic security of individuals as they age, AARP seeks to increase the availability, security, equity, and adequacy of public and private pension, health, disability and other employee benefits.

The protections afforded by the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001, are of vital concern to workers of all ages and to retirees, as the quality of workers' lives in retirement depends heavily on their eligibility for, and the amount of, their retirement and welfare benefits. It is important to ERISA plan participants to ensure that plan assets will be available to pay the benefits to which they are entitled and that these assets are used exclusively for the benefit of participants. ERISA § 404(a)(1)(A), 29 U.S.C. § 1104

[1] In accordance with this Court's Rule 37.6, no party's counsel wrote this brief in whole or in part and no person other than *amicus* or its counsel made a monetary contribution intended to fund the preparation or submission of the brief. The parties have consented to the filing of amicus briefs and have filed letters reflecting their blanket consent with the Clerk of the Court.

(a)(1)(A). To this end, plan participants have a significant interest in ensuring that fiduciaries properly and prudently administer the plan and manage plan assets.

Given the primacy of defined contribution plans in the American workplace, it is imperative that fiduciaries of ERISA-governed plans be held to a high standard of duty to manage plans prudently. Accordingly, resolution of the issues in this case will have a direct and vital bearing on plan participants' ability to protect their retirement accounts from mismanagement and to ensure economic security in retirement. In light of the significance of the issues presented by this case, AARP respectfully submits this brief, as amicus curiae, to facilitate a full consideration by the Court.

SUMMARY OF ARGUMENT

Defined contribution plans are now the predominant type of employer-sponsored retirement plans. Millions of participants are enrolled in employer-sponsored defined contribution plans that offer employer stock as an investment option, a matching contribution, or both. It is crucial that fiduciaries of these plans adhere to ERISA fiduciaries' duty of prudence in monitoring the plan's retention of employer stock as an investment option. ERISA's legislative history lends no support to Petitioner's argument in favor of a presumption of prudence for ESOP fiduciaries.

An ESOP fiduciary is exempt from the prudence standard only insofar as diversification from employer stock is concerned. Section 404(a)(2) does not exempt ERISA fiduciaries from the duty to exercise prudence in all investment matters, much less in the decision to permit the retention of employer stock as a plan investment option. Thus the retention of qualified employer stock may be imprudent for reasons other than non-diversification. ERISA's "care, skill, prudence, and diligence" requirement remains fully applicable, and no presumption as to any one of those fiduciary attributes or duties applies. If the Court is inclined to find that the *Moench* presumption has any application, then it should be applied only as an evidentiary standard. This Court should not insulate ESOP fiduciaries from meaningful judicial review by imposing an insurmountable pleading requirement on injured participants in company-stock plans.

ARGUMENT

I. WITH DEFINED CONTRIBUTION PLANS BEING THE PRIMARY FORM OF EMPLOYER-SPONSORED RETIREMENT PLANS, PLAN FIDUCIARIES MUST ADHERE TO ERISA'S DUTY OF PRUDENCE IN MONITORING THE PLAN'S RETENTION OF EMPLOYER STOCK AS AN INVESTMENT OPTION.

A. Defined Contribution Plans Are The Primary Vehicle For Retirement Savings Today.

In *LaRue v. DeWolff, Boberg & Associates*, this Court recognized that "[d]efined contribution plans dominate the retirement plan scene today." 552 U.S. 248, 255 (2008). In contrast to the era of ERISA's enactment, the traditional regime of defined benefit plans has waned in recent years, both in terms of the number of plans and the number of participants enrolled in those plans. *Id.* The number of participants in employer-sponsored defined contribution plans and the magnitude of assets held by those plans are significant. The defined contribution paradigm is entrenched in today's retirement, tax and social policy, and it has changed the way that American workers form and implement plans to finance their retirement. *See* Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 457-58 (2004).

According to the most recent statistics released by the U.S. Department of Labor, more than 88 million participants are currently covered by the 638,390 defined contribution plans in existence. *See* U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2010 Form 5500 Annual Reports* (June 2013), http://www.dol.gov/ebsa/pdf/2011pension planbulletin.pdf. The total assets held by these plans exceeded $4.2 trillion as of the third quarter of 2012. *Id*. A recent survey indicates that 79% of respondents believe that their defined contribution plans can help them to meet their retirement goals.[2] *See* American Benefits Council, *401(k) fast facts* (Apr. 2013), *available at* http://www.americanbenefitscouncil .org/documents2013/401k_stats.pdf.

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[2] Widespread public support for the defined contribution regime is well-founded in theory. A 2007 study by the Congressional Research Service reveals that a participant could save an average of $468,000 by age 65, but only if he or she contributes 8% of earnings each year for 30 years (starting at age 35) to an account that invests in a combination of stocks and bonds earning a 5.5% annual return. Patrick Purcell & Debra B. Whitman, Cong. Research Serv., Rl33845, *Retirement Savings: How Much Will Workers Have When They Retire*? (2007), *available at* http://research.policyarchive.org/3111.pdf. However, a 2012 survey showed that employees over age 60 with the longest tenures only had $250,000 in their account balances. *See* Jack VanDerhei, Sarah Holden, Luis Alonso & Steven Bass, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2012* at 11 (Employee Benefits Research Inst., Issue Brief No. 394, 2012), *available at* http://www.ebri.org/pdf /briefspdf/EBRI_IB_012-13.No394.401k-Update-2012.pdf.

B. Millions of Participants Are Enrolled In Employer-Sponsored Defined Contribution Plans That Offer Employer Stock As An Investment Option, A Matching Contribution, Or Both.

Within the realm of workplace retirement plans are defined contribution plans that feature employer securities as an available investment option. Company stock plans, as part of the employment bargain, offer plan participants stock in their own employer, either as an investment option, a matching contribution or both, depending on the terms of the particular employer's plan. Employer stock might be offered as simply another investment option within a plan, or it can be offered as part of an ESOP.[3] While it is rare for a small employer to adopt a plan that features an employer stock option, nearly 60% of participants enrolled in large employer plans covering at least 5000 participants were offered employer stock as an investment option in 2011. *See* Jack VanDerhei, Sarah Holden, Luis Alonso & Steven Bass, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2012* at 8 (Employee

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[3] An ESOP is usually a stand-alone plan that invests funds primarily in employer securities and is financed exclusively by employer contributions. Stephen P. Utkus & Jean A. Young, *The evolution of company stock in defined contribution plans*, VANGUARD at 4 (Mar. 2012), available at https://institutional.vanguard.com/iam/pdf/CRREVO.pdf?cbdForceDomain=false. An ESOP can also be combined with a 401(k) plan, referred to as a "KSOP." *Id.* An ESOP "encourages concentrated single-stock risk as a mechanism for fostering alignment of employee interests with those of the company and its owners." *Id.*

Benefits Research Inst., Issue Brief No. 394, 2012), *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_012-13.No394.401k-Update-2012.pdf (hereinafter VanDerhei, Holden, Alonso & Bass).

A study by the Vanguard Group confirms that company stock plans tend to be larger, "with a median participant population of 2,399 versus 205 for non-company stock plans." Stephen P. Utkus & Jean A. Young, *The evolution of company stock in defined contribution plans* at 6, VANGUARD (Mar. 2012), *available at* https://institutional.vanguard.com/iam/pdf/CRREVO.pdf?cbdForceDomain=false (hereinafter "Utkus & Young"). At the close of 2012, approximately 36% of participants were enrolled in plans that offered employer securities as an investment option under the terms of the plan. *See* VanDerhei, Holden, Alonso & Bass, *supra,* at 19. More than half of employees who are offered company stock choose to make the investment. Utkus & Young, *supra,* at 6.

In 2009, the aggregate dollar amount of employer stock held in retirement plans equaled approximately $166 billion. Gary V. Engelhardt, *The Pension Protection Act of 2006 and Diversification of Employer Stock in Defined Contribution Plans* (Ctr. For Ret. Research, CRR WP 2011-20, Nov. 2011), *available at* http://crr.bc.edu/working-papers/the-pension-protection-act-of-2006-and-diversification-of-employer-stock-in-defined-contribution-plans/. In 2010 that total jumped to $240 billion. David Blanchett, *Employer Stock Ownership in 401(k) Plans and Subsequent Company Stock Performance,*

MORNINGSTAR INVESTMENT MANAGEMENT (July 2013), *https://corporate.morningstar.com/us/documents/MethodologyDocuments/ResearchPapers/Employer-Stock-Ownership-in-401k-Plans.pdf* (hereinafter Blanchett).

Workers at large companies are the most likely to maintain a concentrated position in employer securities. For example, employees at Exxon Mobil Corp., McDonald's, and Lowe's Companies had more than 50% of their total 401(k) plan assets invested in their company's stock at the end of 2011. *See* Blanchett, *supra*. Among those employers actively offering employer stock plans, 55% of participants have retirement funds invested in their employer's securities. Utkus & Young, *supra*, at 6. These participants tend to be older employees with longer tenures at their employers' businesses. *Id.*

Participants own employer securities for a number of reasons. Many companies match their employees' salary deferrals with company stock, or allow employees to purchase their stock at a discount price. Blanchett, *supra,* at 6. Company stock plans tend to have higher median contributions by both employers and employees, resulting in higher median account balances in company stock plans than the balances under non-company-stock plans. Utkus & Young, *supra*, at 8. Indeed, the average account balance of a participant in a plan that actively offers company stock is 27% higher than the balance of a participant who is not offered company stock. *Id.*

In addition, it is well-established that the number and character of investment options offered by a plan significantly affects how participants opt to allocate their assets in their participant-directed accounts. Employers play a significant role in motivating their employees to invest in company stock since employers are responsible for selecting the menu of available investment options, including the decision of whether or not to offer employer securities. Plan sponsor design decisions have the strongest and direct correlation to participant holdings in employer stock. One study finds that the mere act of offering employer stock as an option under the plan prompts employees to allocate significant amounts of money to that investment option. Olivia S. Mitchell & Stephen P. Utkus, *Company Stock and Retirement Plan Diversification* 12 (Pension Research Council of the Wharton Sch. Of the Univ. of Penn., PRC WP 2002-4, 2002), *available at* https://institutional.vanguard.com/iam/pdf/CRR_company_stock.pdf.

Researchers have found that investors are biased towards stocks that are "geographically proximate and familiar, which explains the desire for an employee to invest in his employer's stock since it usually is both geographically proximate and familiar (known as the "local bias effect"). Blanchett, *supra*, at 7. They have also found that in plans that include an employer match of company stock, the match represents an implicit endorsement of the company, and participants are more than twice as likely to have concentrated positions in employer stock when a company-stock match is provided (known as the

"endorsement effect"). Blanchett, *supra*, at 6. The odds of having a concentrated portfolio increases further when employers provide participants with other non-matching contributions in employer stock in addition to the match. *Id.* at 2. Indeed, 50% of participants have a concentrated position of greater than 20% when an organization directs any employer contributions to company stock. Utkus & Young, *supra*, at 12. This is striking in comparison to the 15% of participants who have concentrated holdings at companies that make employer contributions in cash. *Id.*

C. Significant Losses In Account Balances Due To Fiduciaries' Failure To Monitor Employer Securities Wreaks Havoc On Employees' Retirement Security.

Obviously, a stock portfolio concentrated in employer securities can pose a significant threat to a participant's retirement security because such portfolios displace investments in diversified equity funds and other balanced funds. *Id*. at 12. Against the backdrop of the various ways that employers, whether intentionally or unintentionally, encourage employees to purchase company-stock, it is significant that employees are inclined to greatly underestimate the risks attendant to concentrating their investments in employer securities and are unduly influenced by past stock performance.

Although Congress attempted to remedy some of these problems by mandating certain

diversification rights in the 2006 Pension Protection Act (PPA), these protections, not surprisingly, have proven largely inadequate. First, no research indicates that the PPA diversification rights, by themselves, have contributed in any material way towards reducing company stock exposure among plan participants due to "the well-documented inertia that characterizes participant investment behavior in DC accounts." Utkus & Young, *supra*, at 3. Second, given just how little the average participant understands as to the need for and methods of planning for retirement, these PPA rights are not valuable to participants. To illustrate, data collected for the National Financial Capability Study revealed that only half of those surveyed understood that, according to generally accepted principles of investment, buying a stock mutual fund provides a safer return than concentrating money in a single company's stock. Annamaria Lusardi & Olivia S. Mitchell, *Financial Literacy and Retirement Planning in the United States* 2, 4 (Nat'l Bureau of Econ. Research, NBER Working Paper No. 17108, 2011), *available at* http://www.nber.org/papers /w17108. As another survey reveals, 25% of respondents believe that concentrating their investments in company stock is less risky than a diversified portfolio, with another 39% asserting that the level of risk is equivalent. *See* Shlomo Benartzi, Richard H. Thaler, Stephen P. Utkus & Cass R. Sunstein, *The Law and Economics of Company Stock in 401(k) Plans*, 50 J.L. & Econ. 45, 54 (2007) (hereinafter Benartzi, Thaler, Utkus & Sunstein).

As a corollary, individuals also grossly underestimate the amount of money they will need during retirement. In 2004, 45% of households were classified as "at risk," meaning that almost half of American households were "predicted to fall significantly short of having enough money at retirement to maintain their pre-retirement standard of living." Craig R. M. McKenzie, *Misunderstanding Savings Growth: Implications for Retirement Savings Behavior*, JOURNAL OF MARKETING RESEARCH (2011), *available at* http://www.marketingpower.com/aboutama/documents/jmr_forthcoming/misunderstanding_savings_growth.pdf. Misperceptions about the risk of concentrating assets in employer securities, combined with a lack of or minimal amount of investment knowledge and sophistication, can have devastating consequences for participants with concentrated holdings in company-stock.

As this Court has recognized, defined contribution plans (in addition to Social Security benefits) are the primary vehicle for providing retirement income, *LaRue*, 552 U.S. at 255, n.5, and employer-sponsored retirement plans are one of the most significant financial assets for most workers and retirees. Significant declines in the value of employer stock thus can create dire consequences for those workers and retirees who hold employer stock in their retirement plans. Since the likelihood of a company offering an employer-stock plan grows in proportion to the size of that company, a decline in the value of a large company's stock means that a colossal loss in retirement income occurs

simultaneously for a substantial number of employees.

Lessons from our not-so-distant past have certainly demonstrated the pitfalls of concentrated investments in employer stock by plan participants working for large companies. Consider, by way of example, the infamous Enron debacle of the early 2000s. When the value of Enron's stock plummeted from over $80 per share to less than $0.70 per share between 2001 and 2002, 62% of Enron employees' 401(k) assets were invested in Enron stock. Consequently, when the stock fell, employees lost not only their jobs, but also between 70 and 90% of their retirement savings. PATRICK J. PURCELL, CONG. RESEARCH SERV., RS21115, *The Enron Bankruptcy and Employer Stock in Retirement Plans*: *Investment Risk and Retirement and Retirement Security* 1 (2003), http://congressionalresearch.com/RL31507/document.php?study=Employer+Stock+in+Retirement+Plans+investment+Risk+and+Retirement+Security. About 20,000 participants in Enron retirement plans are estimated to have lost about $1.1 billion in their accounts. Stephanie Armour, *Enron woes reverberate through lives*, USA TODAY (Jan. 27, 2006), *available at* http://usatoday30.usatoday.com/money/industryes/energy/2006-01-25-enron-employees-usat_x.htm?csp=34. Similarly, WorldCom's 401(k) plan held 32% or $642.3 million in employer stock when the stock dropped from $56 to $0.14 per share. David E. Rovella, *MCI, WorldCom's Ebbers Settle 401K Suit for $51 Mln (Update2)* Bloomberg, July 6, 2004, *available at* http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aqypuAjvRgpk. Another

example is found in the Lehman Brothers' bankruptcy, where more than 13,000 employees (half the company's workforce) lost $228.7 million in retirement savings in addition to their jobs immediately after the events that toppled the company. The collapse and subsequent takeover of Bear Stearns decimated millions of dollars in shareholder value over the course of a few days, with the pain particularly felt by the 14,000 employees who owned 30% of the company's stock when it went under. Scott Horsley, *Bear Stearns Collapse Costly to Many*, NPR (Mar. 17, 2008), *available at* http://www.npr.org/templates/story/story.php?storyId =88415073.

Particularly when a participant suffers these losses in income at or near retirement age, the long-term effect wreaks havoc, financially and emotionally, on the individual and his or her family, since the participant does not have time to make up for the losses. Countless employees, especially those over age 45, have been compelled to postpone retirement and return to work (frequently at lower pay), or have had to radically adjust their lifestyles after their nest eggs have suddenly vanished. *See, e.g.*, Colette Thayer, *Retirement Security or Insecurity? The Experience of Workers Aged 45 and Older* at i-iii (2008), *available at* http://www.aarp.org /work/retirement-planning/info-10-2008/retirement_ survey_08.html; Armour, *supra*.

While captivating, the headlines detailing the respective falls and subsequent legal battles faced by these corporate giants should not overshadow the

heart rending, personal stories of their former employees. To illustrate, Enron's collapse affected solidly middle class individuals in tragic ways. At Portland General Electric, the Oregon utility once acquired by Enron, older married couples were reported to have lost as much as $800 to $900 thousands in retirement savings. Richard A. Oppel Jr., *Employees' Retirement Plan Is a Victim as Enron Tumbles*, N.Y. TIMES (Nov. 2001), *available at* http://www.nytimes.com/2001/11/22/business/employees-retirement-plan-is-a-victim-as-enron-tumbles.html. One former Enron employee, Mark Lindquist, a Web designer who lost his job and all his benefits, was reported as struggling to figure out how he can pay for therapy for his autistic son, while Clyde Johnson, a single parent, lost his ability to make timely payments on the home shared with his 11-year old son. Countless others were released on a job market where Enron had won little goodwill. *See* Rick Bragg, *ENRON'S COLLAPSE: WORKERS; Workers Feel Pain of Layoffs And Added Sting of Betrayal*, N.Y. TIMES (Jan. 2002), *available at http://www.nytimes.com/2002/01/20/us/enron-s-collapse-workers-workers-feel-pain-layoffs-added-sting-betrayal.html*. Enron provided a mere $4,500 in severance pay, regardless of an employee's tenure, and all health and medical insurance contracts for the 5000 terminated employees were cancelled. *See* Steve Paulson, *Workers lose jobs, health care and savings at Enron*, WSWS (Jan. 2002), https://www.wsws.org/en/articles/2002/01/enro-j14.html. By the time an employee could overcome the *Moench* presumption, the company has collapsed causing real damage to employees' lives.

Yet despite these well-publicized incidents and personal stories, it is still common for employees to have significant portions of their retirement investments concentrated in company stock. *See* Benartzi, Thaler, Utkus & Sunstein, *supra*.

Sadly, the total losses to Enron and WorldCom employees were only fractionally recouped during the lawsuits that ensued following the respective disasters. Receiving what is still the largest settlement to date for ERISA "company stock" litigation, Enron employees sued and recovered only $250 million of the total $1.3 billion lost in the collapse. Meanwhile, the recovery to WorldCom participants was approximately $48.435 million out of the $800 million dollar loss.

As with Enron and WorldCom, by the time an employee can show that a fiduciary's failure to monitor and take action concerning employer stock is imprudent, it is too late. There are few assets from which employees can recover, leaving the employees holding the bag for the fiduciary's imprudent actions. It certainly seems counter-intuitive that a statute designed to protect the retirement security of employees would leave them no better off than the impetus—the failure of Studebaker—for its enactment.

II. THE PARADIGM SHIFT TO DEFINED CONTRIBUTION PLANS RECOGNIZED BY THE COURT NEGATES MUCH OF THE LEGISLATIVE HISTORY UPON WHICH PETITIONER RELIES.

Petitioners and their amici rely upon irrelevant portions of legislative history. Petitioners argue that the Tax Reform Act of 1976 recognized that ESOPs should not be "treat[ed]" like "conventional retirement plans" and warned against rulings that could "block the establishment and success of these plans." (Petitioners' Br. 17-18). They caution that "Congress specifically warned against 'rulings which treat employee stock ownership plans as conventional retirement plans'" in 1976 (Petitioners' Br. 39-40) and argue that this "further supports a robust presumption of prudence" because a "less deferential standard would undermine Congress's policy of encouraging employers to voluntarily offer ESOPs" and "dissuad[e] employers from offering these plans." (Petitioners' Br. 17-18, 37-38). While potential liability might be a consideration for plan sponsors, it would have to be weighed against the multiple benefits of employee stock ownership touted by Petitioners and their amici.[4] The

[4] This disincentive assertion is questionable given the other benefits implicit within the offering of an employer stock fund including, for example, "an affordable means of raising capital" that generally leads to "increases in productivity, sales, and hiring[;]" makes employees feel "more satisfied[;]" and the provision of "significant tax advantages. Amicus Br. of Chamber of Commerce 5-13. As Petitioners recognize, Senator Long stated into the congressional record in 1983 that "companies with employee ownership are likely to be more productive and

little other legislative history relied upon by Petitioners[5] adds little, if anything, to the analysis. For example, the 1990 statement is a historical recap of why ESOPs were allowed by ERISA.

Petitioners and their amici, to the extent they rely upon legislative history, ignore the lack of flow in their argument. As AARP emphasizes at the outset of this brief, in 2008, this Court recognized that the "landscape of employee benefit plans . . . has changed" and that "[d]efined contribution plans dominate the retirement plan scene today. In contrast, when ERISA was enacted, and when [*Massachusetts Mut. Life Ins. Co. v.] Russell*, [473 U.S. 134 (1985)] was decided [in 1985], the defined benefit plan was the norm of American pension

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more profitable than those without, and the more ownership held by employees, the better the performance of the company." (Petitioners' Br. 38 n. 15.) That companies would be dissuaded from accepting these benefits without a robust presumption of prudence is a baseless statement.

[5] The remainder of legislative history relied upon by Petitioners' includes the Senate Special Committee on Aging, Developments in Aging: 1989, S. Rep. No. 101-249, at 94 (1990), for the proposition that "Employee stock ownership plans were promoted as a means for transferring the ownership of a company's capital to its workers" and Staff of S. Committee on Finance, Employee Stock Ownership Plans, 96th Cong., 2d Sess. 27 (Comm. Print 1980), noting "Congressional intent that an ESOP is not primarily a retirement plan, but rather has as its primary objective the providing of stock ownership interests for employees." (Petitioners Br. 27).

practice."[6] Reliance on legislative history from the prior landscape, when ESOPs were not "retirement plans" in the sense that they are today does not make sense. To say that an ESOP fund in a plan such as is here before the Court—the purposes of which Plan are "to provide retirement and other benefits for Participants and their respective beneficiaries." J.A. 284—should not be treated as a retirement plan is to ignore the shift towards defined contribution retirement plans recognized by *LaRue* as the current standard. Indeed, the legislative history relied upon by Petitioners largely predates the existence of 401(k) defined contribution plans altogether.[7] Section 401(k) plans were first established in 1978 by Section 135(a) of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, 2785 (Nov. 6, 1978). They did not exist when the legislative history Petitioners' most emphasize was made. Thus no legislative history from the Tax Reform Act of 1976 can logically support Petitioner's position.

Simply stated, legislative history which predates both the enactment of 401(k) plan statutory provisions and the sea change towards the predominance of such plans sheds no light on how ESOPs in the current era should be regarded.

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[6] *LaRue*, 552 U.S. at 254-55 (citations and internal quotation marks omitted).

[7] Subsequent legislative history is generally limited to tax benefits for certain ESOP transactions. *E.g.*, Amicus Br. of ESOP Ass'n 22-23. It does not follow from the allowance of certain tax deductions that a presumption of prudence should be read into ERISA.

III. THIS COURT SHOULD NOT INSULATE ESOP FIDUCIARIES FROM MEANINGFUL JUDICIAL REVIEW BY IMPOSING AN INSURMOUNTABLE PLEADING REQUIREMENT ON INJURED PARTICIPANTS IN COMPANY-STOCK PLANS.

For all of the compelling reasons advanced by Respondents, this Court should not adopt the "presumption of prudence" set forth in *Moench v. Robertson* by the Third Circuit. But if this Court were inclined to endorse *Moench,* then the Court should read *Moench only* as establishing an evidentiary presumption in favor of ESOP fiduciaries rather than imposing a heightened pleading requirement on injured plan participants. 62 F.3d 553 (3d Cir. 1995). *Moench* considered whether an ESOP fiduciary abused its discretion by investing plan assets solely in company stock as the company deteriorated into bankruptcy, "rendering the employee's ESOP accounts virtually worthless."[8] The

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[8] *Moench v. Robertson,* 62 F.3d 553, 559 (3d Cir. 1995). *Moench* involved an ESOP that was a stand-alone fund designed to provide employees with the opportunity to invest in employer stock, not an ESOP which was part of 401(k) retirement plan as is the case here. *Id.* at 557. The plan documents directed the plan's fiduciaries to invest the assets primarily in employer securities, but granted those fiduciaries some leeway "to invest in other vehicles," including "short-term money market instruments." *Id.* at 559. The district court had ruled that ESOP plan documents absolved the fiduciaries from any liability that could potentially attach to their decision to remain invested in employer securities. *Id.* at 650. On appeal, the Third Circuit rejected the defendants' argument that ESOP fiduciaries are

Moench court announced that a rebuttable presumption of prudence applies to shelter an ESOP fiduciary's investment decisions from strict judicial scrutiny. *Id.* at 570. An ESOP fiduciary is presumed to comply with ERISA's duty of prudence when it decides to invest plan assets in employer securities. *Id.* To rebut the presumption, a plaintiff must introduce evidence to "show that the ERISA fiduciary could not have reasonably believed that the plan's drafters would have intended under the circumstances that he continue to comply with the ESOP's direction that he invest exclusively in employer securities." *Id.* at 571.

The premise of the *Moench* presumption is the notion that the dual nature of an ESOP as both a retirement plan and a "technique of corporate finance" to encourage employee ownership creates an inherent tension for plan fiduciaries. *Moench*, 62 F.3d at 569. ESOP fiduciaries must wear "two hats" as they balance their sometimes competing obligations to administer the ESOP in compliance with "the provisions of both a specific employee benefits plan and ERISA." *Id.* at 569; *White v. Marshall*, 714 F.3d 980, 988 (7th Cir. 2013) ("ERISA's simultaneous demands to comply with plan documents and to exercise prudence in choosing investment options for plan participants can place fiduciaries on a razor's edge."). In recognition of this careful balancing act, the *Moench* court found it best to attach a certain

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immune from liability if diversification of investments is prohibited by the plans they administer. *Id.* at 571. The Third Circuit reasoned this was not what Congress intended. *Id.*

degree of deference to the investment decisions of ESOP plan fiduciaries.

The *Moench* presumption does not confer blanket immunity from liability for ESOP fiduciaries, even where the plans they administer prohibit diversification, because ERISA only exempts ESOP fiduciaries from "certain per se violations" of the duty of prudence. *Moench*, 62 F.3d at 569-71. An ESOP fiduciary is exempt from ERISA's prudence standard only insofar as it relates to the duty to diversify. ESOP fiduciaries are still obligated to act in accordance with their duties of prudence and loyalty when they decide how and when to invest, regardless of the exception from strict liability for failure to diversify. *See, e.g.*, *Eaves v. Penn*, 587 F.2d 453, 459 (10th Cir. 1978) ("[I]n making an investment decision of whether or not a plan's assets should be invested in employers securities, an ESOP fiduciary, just as fiduciaries of other plans, is governed by the 'solely in the interest' and 'prudence' tests of [ERISA §404]."); *see also Fink v. Nat'l Sav. & Trust Co.,* 772 F.2d 951, 955-56 (D.C.Cir.1985) ("The investment decisions of a profit sharing plan's fiduciary are subject to the closest scrutiny under the prudent person rule, in spite of the strong policy and preference in favor of investment in employer stock."). Quite simply, section 404(a)(2) is not an exception when investing in qualified employer stock may be imprudent for reasons other than non-diversification; in those situations, ERISA's "care, skill, prudence, and diligence" requirement remains fully applicable.

Importantly, the *Moench* plan was a true ESOP with no investment options other than company stock available to the participants. On the other hand, the Fifth Third Plan consists of an employer stock fund (ESOP) that is but one of numerous investment vehicles offered as constituents of a larger Plan,[9] and the Plan language explicitly declares that "[T]he purposes of the Plan are to provide retirement and other benefits for Participants and their respective beneficiaries."[10] Therefore whatever value the Court sees fit to attach to the *Moench* approach in the overall ERISA scheme, it should be evident that it is not applicable in a case such as this. Rather, insofar as the statutory language compels that the fiduciary conduct itself as a prudent man dealing with an enterprise of like character and like aims, and the Plan's stated character and aim is to promote retirement savings, ERISA's text requires that a court consider the conduct "under the circumstances then prevailing." Section 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B). Viewed in that light, once Company stock became an overly risky retirement investment for the Plan participants because of, inter alia, the vastly changed circumstances from when the

[9] J.A. 123-33, 140-43.

[10] J.A. 284 (Plan Document, Article 1, § 1.2; J.A. 146 (August 8, 2007 Summary Plan Description) and J.A. 222 (October 1, 2008 Summary Plan Description) (both stating "The Plan is for your retirement.")

settlors adopted the Plan,[11] a prudent fiduciary tasked with the responsibility of prudently managing retirement assets would not have stood idly by and watched as tens of millions of dollars' worth of Plan assets vanished which, as clearly alleged in Respondent's Complaint, was occurring. After all, "[a] trustee who simply ignores changed circumstances that have increased the risk of loss to the trust's beneficiaries is imprudent." *Armstrong v. LaSalle Bank Nat'l Assoc.*, 446 F.3d 728, 734 (7th Cir. 2006).

To the extent that this Court is inclined to endorse *Moench* at all, even in the face of convincing reasons not to adopt it, this Court must find that the *Moench* presumption is an evidentiary standard that controls a plaintiff's ultimate burden of proof at trial in an action against ESOP plan fiduciaries. The procedural postures of *Moench* and *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir. 1995), the first case to apply the *Moench* presumption, indicate that the presumption of prudence is not an additional pleading requirement. *Moench* conducted a *de novo* review of the evidentiary record established in the trial court, then vacated the grant of summary judgment in favor of the fiduciary defendants and remanded the case for "further proceedings in which the record may be developed and the case may be judged on the basis of the principles set forth" in the Third Circuit's opinion. 62 F.3d at 572. In the context of a similar procedural posture, the Sixth Circuit in *Kuper* affirmed an entry of summary judgment in

[11] J.A. 55-57 (allegations of the Complaint that detail how Fifth Third no longer utilizes conservative lending practices as it historically did).

favor of the plan's fiduciaries, agreeing that the failure "to diversify or liquidate the ESOP funds during the pendency of [a] trust-to-trust transfer" did not rise to the level of breach of fiduciary duty. 66 F.3d. at 1450. The *Kuper* court grounded its holding on "the stipulated record of the case," which included "the parties' trial briefs, proposed findings of fact and conclusions of law." *Id.* at 1452.

Both *Moench* and *Kuper* accordingly applied the presumption of prudence to a fully developed evidentiary record, and not merely the pleadings. The implication is that the presumption was not intended to serve as a supplementary pleading requirement to test the sufficiency of a participant's complaint upon a motion to dismiss. *See also Pfiel v. State Street Bank & Trust Co.*, 671 F.3d 585, 592 (6th Cir. 2012) (holding that *Moench* did not create an additional pleading requirement based on "the plain language of *Kuper* itself [explaining] that an ESOP plaintiff could 'rebut this presumption of reasonableness by *showing* that a prudent fiduciary acting under similar circumstances would have made a different investment decision'").

Applying *Moench* upon a motion to dismiss will result in premature dismissal of plaintiffs' complaints because "whether the defendants breached their fiduciary obligations require[s] the development of the fact[ual record]." *Rankin v. Rots*, 278 F.Supp. 2d 853, 879 (E.D. Mich. 2003) (refusing to apply ESOP presumption on a motion to dismiss). Plaintiffs should not be required to make out a prima facie case of fiduciary breach at the pleading stage

because, as the First Circuit articulated in *Lalonde v. Textron, Inc.*, "further record development—and particularly input from those with expertise in the arcane area of the law where ERISA's ESOP provisions intersect with its fiduciary duty requirements—[is] essential to a reasoned elaboration of that which constitutes a breach of fiduciary duty in this context." 369 F.3d 1, 5 (1st Cir. 2004); *accord Quan v. Computer Sci. Corp.*, 623 F.3d 870 (9th Cir. 2009) (construing the plaintiff's burden as an evidentiary standard).

Other Circuit Courts to consider the issue agree that the *Moench* presumption is an evidentiary standard. For example, the Fifth Circuit in *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243 (5th Cir. 2008), weighed the allegations of imprudence against the backdrop of the facts introduced in the lower court in opposition to the fiduciary's motion for summary judgment. *Id.* at 254-56 (noting that application of *Moench* does not turn on "pleading artifices")[12]. Similarly, in *Steinman v. Hicks*, the Seventh Circuit held that a trust-to-trust transfer of plan assets to an acquiring corporation was not imprudent because the Plaintiffs failed to "introduce evidence of the overall risk created by the retirement package that they acquired when they became employees of [the new company]." 352 F.3d 1101, 1106 (7th Cir. 2003). *Steinman* concluded that circumstances attendant to the acquisition, the plan's short investment horizon and the relative risk profiles of fixed-income securities versus stock did

[12] *But see Kopp v. Klein*, 722 F.3d 327, 399 (5th Cir. 2013).

not "demonstrate imprudence in the management of an ESOP, at least on the basis of the record compiled in the district court." *Id.* at 1103-05.

A decision to apply the *Moench* presumption at the motion to dismiss stage will effectively insulate ESOP fiduciaries from any liability for their investment decisions, a result that Congress could not have anticipated. Congress did not intend to exempt plan fiduciaries wholesale from judicial review by imposing a potentially insurmountable pleading burden on ERISA plaintiffs. "ESOP fiduciaries must act in accordance with [ERISA's] duties of loyalty and care" and are therefore covered by "ERISA's stringent requirements" except to the extent of the "few select provisions" specially carved out by Congress. *Moench*, 62 F.3d at 569. ERISA §406 and §407 specifically release ESOP fiduciaries from "certain per se violations" of the duty of prudence, while the *Moench* presumption provides them with a shield against strict judicial scrutiny. *Id.* at 570. ESOP fiduciaries are thus already afforded special protections against liability for their actions and inactions. It is not the province of courts to engraft an essentially absolute judge-made protection on ERISA's "comprehensive and reticulated" statutory scheme. *Nachman Corp. v. PBGC,* 446 U.S. 359, 361 (1980).

The Court should not place the retirement assets of millions of private employees at risk by insulating fiduciaries' investment decisions from meaningful judicial review. The danger of adopting *Moench* as a pleading standard is especially apparent

given that the legacy of the Third Circuit's decision is still evolving in the lower courts. As recently as 2007, *Edgar v. Avaya, Inc.*, 503 F.3d 340 (3d Cir. 2007), extended the *Moench* presumption to all eligible individual account plans (EIAPs). Other courts have since followed suit. *See In re RadioShack Corp. "ERISA" Litig.*, 547 F. Supp. 2d 606, 613 (N.D. Tex. 2008) (finding that the *Moench* presumption extends to all EIAPs).

A finding that *Moench* applies at the motion to dismiss stage will deprive countless injured ESOP participants of his or her day in court, while safeguarding the unscrupulous practices of breaching fiduciaries. Participants will almost always be unable to produce satisfactory evidence of breach absent formal discovery, as the fiduciaries are always in possession of the evidence necessary to prove their breach of duty[13]. Without the benefit of discovery,

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[13] The Eight Circuit in *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 598 (8th Cir. 2009) stated:

Congress intended that private individuals would play an important role in enforcing ERISA's fiduciary duties-duties which have been described as "the highest known to the law." *Donovan v. Bierwirth*, 680 F.2d 263, 272 n. 8 (2d Cir.1982). In giving effect to this intent, we must be cognizant of the practical context of ERISA litigation. No matter how clever or diligent, ERISA plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery commences. Thus, while a plaintiff must offer sufficient factual allegations to show that he or she is not merely engaged in a fishing expedition or strike suit, we must also take account of their limited access to crucial information. If plaintiffs cannot state a claim without pleading facts which tend systemically to be in the sole possession of defendants, the

plaintiffs will fail to satisfy their evidentiary burden at the earliest stage of litigation, which will result in dismissal since a court's inquiry in deciding a motion to dismiss is generally constrained to the facts and documents incorporated in the complaint.

If a court does decide to accept evidence outside the pleadings, it must convert the defendant's motion to one for summary judgment and then "afford the plaintiff an opportunity to submit additional evidentiary material of his or her own." *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429, 431 (7th Cir. 1993). However, the possibility of converting the motion to one for summary judgment does not rectify the problem because it is within the discretion of the trial court to decide whether or not "to allow parties to conduct discovery before entering summary judgment." *Humphreys v. Roche Biomedical Labs., Inc.*, 990 F.2d 1078, 1081 (8th Cir. 1993).

Furthermore, it is dangerous to employ the presumption as a pleading requirement because *Moench* did not provide anything more than a vaguely worded outline of the applicable rebuttal standard. *Moench* states only that plaintiffs are required to "introduce evidence" tending to show that the ESOP fiduciary could not reasonably have

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remedial scheme of the statute will fail, and the crucial rights secured by ERISA will suffer. These considerations counsel careful and holistic evaluation of an ERISA complaint's factual allegations before concluding that they do not support a plausible inference that the plaintiff is entitled to relief.

believed that remaining invested in employer securities "was in keeping with the settlor's expectations of how a prudent trustee would operate." 62 F.3d at 571.

The lack of adequate guidance will undoubtedly deter plaintiffs from filing suit because they will never be sure how much and what kind of evidence they must produce in order to survive a motion to dismiss. Fiduciaries will meanwhile take solace in the lack of objective criteria. Knowing that most complaints will be dismissed, fiduciaries will not be motivated to adhere to the highest standards of loyalty and prudence by seeking independent investment advice or by investigating alternatives before engaging in a particular course of investment.

Moreover, requiring litigants to affirmatively plead enough facts to overcome the *Moench* presumption upon a motion to dismiss also strays from the notice pleading standard announced by this Court in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007). Rule 8(a) of the Federal Rules of Civil Procedure is a liberal pleading standard that "allows broad access to discovery and relies on a motion for summary judgment to eliminate claims lacking merit." *In re Elec. Data Sys. Corp. ERISA Litig.*, 305 F. Supp. 2d 658, 669 (E.D. Tex. 2004). A complaint need not contain "detailed factual allegations" to survive a motion to dismiss. *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009). A complaint must merely contain sufficient factual matter, taken as true, "to state a claim for relief that is plausible on its face."

Id. (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).

"Asking for plausible grounds does not impose a probability requirement at the pleading stage; it simply calls for enough fact to raise a reasonable expectation that discovery will reveal evidence of [unlawful conduct]." *Bell Atl. Corp.*, 550 U.S. at 545. It is therefore inappropriate "under a notice pleading system…to require a plaintiff to plead enough facts to establish a prime facie case" of fiduciary breach. *Swierkiewicz v. Sorema N. A.*, 534 U.S. 506, 511 (2002). In this case, to pass muster under the notice pleading system, the complaint must simply state that the defendants acted in their fiduciary capacity when they decided to continue the investment in employer stock and allege that they breached their fiduciary duties by virtue of that decision given that attendant circumstances so-alleged favored divestment and diversification. *See Vivien v. WorldCom, Inc.*, 2002 WL 31640557, at *5 (N.D. Cal. July 26, 2002).

Consistent with *Bell Atl. Corp.*, these allegations of breach adequately place the "defendants on notice of plaintiffs' theories of a failure to investigate and evaluate an investment, to invest prudently and to act in the sole interest of plan participants." *Id.* A decision to require ESOP participants to plead facts rebutting the *Moench* presumption at the pleading stage clearly conflicts with this Court's interpretation of Rule 8(a) as demanding "a short and plain statement of the claim" that only needs to "give the defendant fair notice of

what the plaintiff's claim is and the grounds upon which it rests." *Swierkiewicz*, 534 U.S. at 512.

Courts generally refuse to consider evidentiary presumptions at the pleading stage, and for good reason. In *Swierkiewicz*, this Court determined that Plaintiffs are not required to plead a prima facie case under the evidentiary framework established for Title VII cases. 534 U.S. at 510-11. The *Moench* presumption is also an "evidentiary standard" because it controls the Plaintiffs' ultimate burden of proof." *In re Elec. Data Sys. Corp. ERISA Litig.*, 305 F. Supp. 2d at 668 (applying *Swierkiewicz*); *cf. Stein v. Smith,* 270 F. Supp. 2d 157, 172 (D. Mass. 2003) (describing the ESOP presumption as an evidentiary matter). As this Court illustrated in *Swierkiewicz*, the problem of applying an evidentiary standard at the motion to dismiss stage is "that revelations in discovery [may] render the [standard] inapplicable." *In re Elec. Data Sys. Corp. ERISA Litig.*, 305 F. Supp. 2d at 172. For example, discovery may reveal that *Moench* does not apply because the plan does not qualify as an ESOP, or because the defendants were not acting in their fiduciary capacities when they engaged in the supposedly imprudent course of conduct. Courts should be reluctant to decide these facts prematurely in the absence of formal discovery. Given the importance Congress placed on the societal good of protecting the retirement savings of American workers, these determinations should not be made until discovery develops a factual record that allows the court to judge the credibility of the witness testimony and exhibits presented by the parties.

CONCLUSION

Respondents adequately pled breaches of the duties of prudent and loyal management. Based on the plain language of the statute, Petitioners are not entitled to any presumption of reasonableness as to whether their actions were prudent (outside of diversification). However, should the Court decide that a presumption is appropriate, such presumption only should be applied as an evidentiary presumption.

For the foregoing reasons, the court should affirm the decision of the Court of Appeals.

Respectfully Submitted,

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