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 OF *AMICUS CURIAE* THE ESOP ASSOCIATION IN SUPPORT OF PETITIONERS

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BRIEF FOR *AMICUS CURIAE* THE ESOP ASSOCIATION IN SUPPORT OF PETITIONERS

INTEREST OF *AMICUS CURIAE*[1]

Founded in 1978, The ESOP Association is a national nonprofit organization of companies with employee stock ownership plans (ESOPs) and service providers with a professional commitment to employee ownership through ESOPs. An ESOP is an employee benefit plan that is designed to invest primarily in the

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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, *amicus* states that no counsel for either party has authored this brief in whole or in part, and that no person or entity, other than *amicus*, has made a monetary contribution to the preparation or submission of this brief.

securities of the sponsoring employer. Like most other employer-sponsored benefit plans, ESOPs are subject to regulation under the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. § 1001, *et. seq.* ("ERISA").

At the end of 2012, there were approximately 12,600 ERISA plans in the United States that provide employees a vehicle for owning their employer's securities. *See* The National Center for Employee Ownership, A Statistical Profile of Employee Ownership, http://www.nceo.org/main/article.php/id/2/ (last visited Feb. 1, 2014) (statistics for ESOP, stock bonus, profit sharing, and Section 401(k) plans that offer employer stock fund investments). These plans have assets of approximately $1.07 trillion. *Id.* Included in these totals are approximately 5,000 companies that are majority owned by the ESOP, with approximately 4,000 of those companies being 100-percent owned by the ESOP. *See* The ESOP Association, ESOP Statistics, http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters#statistics (last visited Feb. 1, 2014). Roughly 97% of these companies are privately owned. *See id.* Data from the National Opinion Research Center's 2010 General Social Survey shows that 18.7 million American workers own stock in their employer through a 401(k) plan, ESOP, direct stock grant, or similar plan. *See* The National Center for Employee Ownership, Data Show Widespread Employee Ownership in U.S., http://www.nceo.org/articles/widespread-employee-ownership-us (last visited Feb. 1, 2014). That means that 17.4% of the total private workforce, but 36.0% of those who work for companies that have stock, own the stock of their employer through some kind of benefit plan. *See id.*

The ESOP Association represents approximately 2,500 companies with ESOPs, companies considering implementing an ESOP, and service providers with a commitment to ESOPs. *See* The ESOP Association, ESOP Fact Sheet, http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters #statistics (last visited Feb. 1, 2014). The ESOP Association participates in as *amicus curiae* in cases like this one, where there is a potential for far reaching effects on ESOP administration, creation or design.

SUMMARY OF ARGUMENT

1. Under the *Moench* presumption that the circuit courts apply in ERISA stock drop cases, an ESOP fiduciary's decision to acquire or hold employer stock is presumed to be prudent, reviewable only for an abuse of discretion. The Government has long opposed the *Moench* presumption, arguing without success that it is inconsistent with ERISA's standard of investment prudence, which the Government contends applies the same way to ESOP fiduciaries as it does to traditional pension plan fiduciaries. ESOPs are undiversified stock bonus plans that are written and statutorily authorized to be invested primarily in the stock of the plan's sponsor. ERISA's prudent man rule requires fiduciaries of employee benefit plans to follow the terms of the plan as written except to the extent inconsistent with ERISA. It also requires them to diversify plan investments so as to avoid the risk of large losses, except that fiduciaries of ESOPs are specifically exempted from this duty. The prudent man rule also requires fiduciaries to discharge their other plan duties prudently.

The Government argues that ERISA's diversification exemption merely absolves ESOP fiduciaries from the duty to reduce risk by spreading plan assets among multiple prudent investments. It does not permit ESOP fiduciaries to concentrate plan assets in an "imprudent investment." Therefore, according to the Government, neither an ESOP fiduciary's duty to follow the plan document nor his exemption from the diversification requirement trump the duty to invest prudently; the ESOP fiduciary's investment decisions, including any decision to hold employer stock in the face of a drop in share price, should be reviewed *de novo* for prudence, not for an abuse of discretion. The Government's theory is that, notwithstanding the inherent imprudence of investing solely in a high-risk asset like a single issue of stock (which ERISA authorizes and encourages for ESOPs), ESOP fiduciaries have a duty to monitor the stock's volatility and intervene if it crosses some (unspecified) threshold of greater risk.

The Court should reject the Government's approach. It is premised on a distorted view of investment prudence that fails to realistically account for the central role that diversification plays in prudent investment. It is unrealistic about how infinitesimal the space is that ESOP fiduciaries must occupy between an undiversified ESOP portfolio invested in the common stock of a single issuer that, leaving aside its statutorily authorized lack of diversification, is "prudent" (*i.e.,* very risky but not *too* risky) and an undiversified ESOP portfolio invested in common stock that, apart from its lack of diversification, is "*im*prudent" (just too risky). When the stock price changes, entrepreneurial plaintiffs' lawyers do not care which side of this "razor's edge" the fiduciary's judgment falls on. In the Sixth Circuit and under the Government's approach, they are given the cudgel of a trial either way – if the share price drops, they sue for waiting too long to act; if the share price recovers and rises, they sue for selling too soon.

The Court should hold that, as a matter of law, ERISA's duty of investment prudence does not require ESOP fiduciaries to act in response to price swings of the publicly traded employer stock held by the plan. The standards by which judgments are to be made in these cases are much too nebulous to serve as the basis for imposing liability on fiduciaries for a "wrong" decision. If the Court declines to so rule, it should adopt the "robust" *Moench* presumption advocated by Petitioners.

2. The Government suggests that ESOP fiduciaries with inside information that the employer's stock is "artificially inflated" have a duty to publicly disclose the information to protect participants from overpaying. The Court should reject this suggestion. In the typical case, the share price of the stock would immediately be adjusted downward by the market to account for the new information, causing the air in the stock to instantly escape. Participants would not be helped.

The Government appears to agree that ESOP fiduciaries have no duty to use material nonpublic inside information to sell "artificially inflated" stock for the benefit of ESOP participants, but Respondents do not agree. The Court should make clear that the duty of prudence governing ESOP fiduciaries does not require them to engage in insider trading in violation of the securities laws.

3. Congress has repeatedly and emphatically endorsed ESOPs because they have a long and rich history of providing the benefits of employee ownership to workers. ESOPs date back to at least

1953, when the first favorable Internal Revenue Service ruling was issued allowing corporations to use stock bonus plans to borrow money for investments in company stock. In the two decades after ERISA's enactment, Congress passed some twenty-five bills promoting and elaborating upon its express policy to encourage employees' ownership of their employer company and the formation of ESOPs. ESOPs serve a variety of purposes in the corporate context. Their primary purpose is not to serve as a retirement vehicle but as an incentive for corporations to structure their financing in such a way that employees can gain an ownership stake in the company for which they work.

ESOPs play a significant role in increasing the total compensation and retirement contributions for employees of companies who sponsor them. Companies sponsoring ESOPs compensate their employees approximately 4.5% more than companies without ESOPs, and companies sponsoring ESOPs provide more employee benefits than non-ESOP companies, with approximately 56 percent of companies sponsoring ESOPs offering a separate retirement savings or defined contribution plan. ESOP-sponsoring companies contribute as much as 75 percent more to their ESOPs than what non-ESOP companies contribute to their primary retirement plans. Companies sponsoring ESOPs also realize advantages in employee productivity and corporate performance. For example, the turnover rate of workers with employee stock ownership is significantly lower than that of employees without employee stock ownership.

ARGUMENT

I. THE COURT SHOULD HOLD THAT THE DUTY OF INVESTMENT PRUDENCE DOES NOT REQUIRE ESOP FIDUCIARIES TO ACT IN RESPONSE TO PRICE SWINGS OF PUBLICLY TRADED EMPLOYER STOCK.

After the Private Securities Litigation Reform Act was passed in 1995 setting heightened pleading requirements for securities cases, ERISA "stock drop" suits rose significantly, in important part due to the attraction of ERISA's lesser pleading standards.[2] At the center of many of these cases, including this one, is whether the fiduciary of an ESOP[3] – which by design

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[2] M. Norman Goldberger, *Responding to Enforcement and Disclosure Requirements in the Securities Law Realm*, Aspatore, October 2011, *available at* 2011 WL 5053667, at *5; *see* Clovis Trevino Bravo, *ERISA Misrepresentation and Nondisclosure Claims: Securities Litigation Under the Guise of ERISA?*, 26 Hofstra Lab. & Emp. L.J. 497, 536-37 (2009) (discussing various procedural and remedial differences that make it less burdensome to proceed with an ERISA fiduciary breach claim based on the same underlying misrepresentations or nondisclosures as a securities class action).

[3] An ESOP is a tax-qualified stock bonus plan "designed to invest primarily in qualifying employer securities." 29 U.S.C. § 1107(d)(6). ESOPs are among the types of plans that fall within the definition of an "eligible individual account plan," which is defined as an "individual account plan which is: (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on the date of enactment of this Act and which on such date invested primarily in qualifying employer securities." To be treated as an eligible individual account plan (under the diversification exemption set forth in 29 U.S.C. § 1104(a)(1)(C), for example) with respect to the acquisition or holding of qualifying employer securities, the plan document must

invests primarily in employer stock – acted prudently before or after a change (usually a drop) in the price of the stock. Plaintiffs in these cases argue that the fiduciary's acquisition or holding of the stock at the time of the change exposed plan participants to "excessive risk" or resulted in their overpaying for "artificially inflated" stock.

Since 1995, the courts of appeals have developed the *Moench* presumption to guide judicial review of fiduciary investment decisions in these cases. *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995). Under the *Moench* presumption, an ESOP fiduciary who acquires or holds employer stock in accordance with the terms of the plan is presumed to have acted consistently with ERISA, and his investment decisions are reviewed only for an abuse of discretion. *Id.* at 571. Applied at the pleading stage by all circuits to have decided the issue except the Sixth,[4] the presumption can be overcome by pleading and establishing that "owing to circumstances not known to the settlor and not anticipated by him [the continued investment in employer stock] would defeat or substantially impair the accomplishment of the purposes of the trust." *Moench*, 62 F.3d at 571. "[T]he court must be governed by the intent of the trust – in other words, the plaintiff must show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's

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"explicitly provide[] for acquisition and holding of qualifying employer securities."

[4] *See 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); *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1281 (11th Cir. 2012); *In re Citigroup ERISA Litig.,* 662 F.3d 128, 139 (2d Cir. 2011); *Edgar v. Avaya, Inc.,* 503 F.3d 340, 349 (3d Cir. 2007).

expectations of how a prudent trustee would operate." *Id.* This has been refined to require a showing that the employer was in an unforeseen "dire situation," or that there were circumstances "clearly implicat[ing] the company's viability as an ongoing concern" which required the fiduciary to override the plan's terms. *Kopp,* 722 F.3d at 339 ("viability of the company"); *In re Citigroup ERISA Litig.,* 662 F.3d at 140 ("dire situation"); *Quan v. Computer Sciences Corp.,* 623 F.3d 870, 882 (2010) ("company's viability as an ongoing concern"); *Edgar,* 503 F.3d at 348 ("dire situation").

The Sixth Circuit has adopted a presumption of prudence, but to overcome it plaintiffs need only show "that a prudent fiduciary acting under similar circumstances would have made a different investment decision." *See Dudenhoefer v. Fifth Third Bancorp,* 692 F.3d 410, 419 (6th Cir. 2012); *Pfeil v. State Street Bank & Trust Co.*, 671 F.3d 585, 592-93 (6th Cir. 2012). Under the Sixth Circuit's standard, which does not apply at the pleading stage, the ESOP fiduciary can be dragged into court and forced to defend himself for doing what the ESOP was designed and sanctioned under ERISA to do, even when reasonable fiduciaries are split as to whether the fiduciary's decisions were reasonable. *Kopp*, 722 F.3d at 337-39; *White,* 714 F.3d at 987.

The Government rejects the *Moench* presumption in any form and has filed briefs opposing it in every circuit where it has been at issue. U.S. Cert. Brief at 8 (arguing against any form of presumption of prudence); Brief of Secretary of Labor as Amicus Curiae in Support of the Plaintiff-Appellant at 16, Kopp v. Klein, No. 12-10416 (5th Cir. Aug. 15, 2012). The Government argues that ERISA imposes a unitary standard of investment prudence on all fiduciaries, regardless of the nature of the plan at issue. U.S. Cert. Brief at 11. As a result, notwithstanding ERISA's express authorization for employers to write plans that "provide[] for acquisition and holding of qualifying employer securities,"[5] removal of the usual 10% limitation on holding qualifying employer securities,[6] permission for the ESOP to borrow funds from the employer or other specified insiders to acquire employer securities,[7] and exemption of ESOP fiduciaries from the duty to diversify plan assets,[8] the Government argues that the decisions of ESOP fiduciaries in connection with the acquisition or holding of employer stock are subject to the same standard of review as fiduciaries of traditional retirement plans. *Id.*

The Government's position is deeply flawed. As explained below, the Government's approach rests on a theoretical view of ERISA's prudent man rule that is not realistic about the circumstances these fiduciaries face. If adopted, it would entitle plaintiffs to expensive discovery and a trial any time the stock issued by the ESOP sponsor dropped significantly or the ESOP sponsor's business model arguably was "too risky." The Court should reject it and instead hold as a matter of law that the duty of investment prudence applicable to ESOP fiduciaries does not require them to act in response to changes in the trading price of qualifying employer securities held by the plan.

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[5] 29 U.S.C. § 1107(d)(3).

[6] 29 U.S.C. § 1107(a), (b).

[7] 29 U.S.C. § 1108(b)(3).

[8] 29 U.S.C. § 1104(a)(1)(C).

A. The Government Trivializes ERISA's Asset Diversification Exemption for ESOP Fiduciaries.

The Government argues that ERISA sets forth "the same general standard" of investment prudence for fiduciaries of ESOPs as it does for fiduciaries of retirement plans. U.S. Cert. Br. at 11. ERISA's diversification exemption, the government argues, "merely absolves [ESOP] fiduciaries" from the duty "to reduce risk by spreading plan assets among multiple prudent investments. It does not permit [ESOP fiduciaries] to concentrate plan assets in an *imprudent* investment." *Id.*

This is a serious distortion of ERISA's prudent man rule that leaves on the cutting room floor virtually everything about the role that diversification ordinarily plays in investment prudence. One cannot understand what is left of the duty to invest prudently after diversification's removal unless one first understands diversification's role.

Diversification is preeminent and indispensible for managing plan investment risk. Under ERISA's "prudent man standard of care," a fiduciary must discharge his duties with respect to a plan "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." 29 U.S.C. § 1104(a)(1)(B). Fiduciaries of typical retirement plans must "diversify[] the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so," *id.* § 1104(a)(1)(C), but ESOP fiduciaries are exempt from the diversification requirement: "in the case of an eligible individual account plan,[9] the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by the acquisition or holding of" qualifying employer securities. *Id.* § 1104(a)(2).

ERISA's fiduciary standards are borrowed and adapted from the common law of trusts. *See Firestone Tire & Rubber Co. v. Bruch,* 489 U.S. 101, 110 (1989). Under trust law (and ERISA), diversification is central to prudent investment and the management of risk. *See* Restatement (Third) of Trusts § 227 cmts. e & g; Uniform Prudent Investor Act § 3; George Gleason Bogert et al*., The Law of Trusts & Trustees* § 612 (3d ed. 2000); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* at 16, 208-09. Understanding this background of diversification is important to understanding diversification's importance to ERISA's duty of prudence.

The duty to diversify originates from the duty to exercise caution in investing. The fiduciary is obligated to keep an eye on both safety of capital and reasonableness of return. Restatement (Third) of Trusts § 227 cmt. e. Return is directly correlated to risk, and all investment, including even in U.S. Treasuries, involves some risk. *Id.* Trustees have a duty to manage risk prudently in light of the short- and long-term needs of the trust. *Id.*

Risk is either diversifiable (which is uncompensated) or nondiversifiable (which is compensated, e.g., through market pricing). *Id*. Diversifiable risks are those that are unique to the

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[9] Eligible individual account plans include ESOPs. 29 U.S.C. § 1107(d)(3), (6).

issuer of the security and include such things as poor earnings, a labor strike, mismanagement, and business failure. *See, e.g.*, Bogert, Law of Trusts & Trustees § 612; Longstreth, Modern Investment Management and the Prudent Man Rule 82. These are the types of risks that can lead to a drop in share price and that are at work in many ERISA stock drop cases. Trustees have a duty to minimize or reduce diversifiable risks. Restatement (Third) of Trusts § 227 cmt. e. As a result, diversification is fundamental to the management of risk, regardless of what level of risk is appropriate to the trust. *Id*. § 227 cmts. e & g.

The Government's contention that the diversification exemption for ESOPs is not authority for fiduciaries to "concentrate plan assets in an imprudent investment" rests on a theoretical understanding of prudence that neglects to account for the enormity of diversification's role. In a portfolio, specific investments are not *per se* prudent or imprudent. The prudence of an investment turns on the appropriateness of its volatility for the portfolio as a whole. Restatement (Third) of Trusts § 227 cmt. f. Common stocks are inherently speculative (to an extent) and among the riskiest investments. *See* Benjamin Graham, The Intelligent Investor 18-34 (rev. ed. 1984). In a diversified portfolio that maintains some investments in stocks, the risk of these investments is managed by spreading the trust's investments in common stocks across multiple issuers and by investing other plan assets in different classes of assets with different risk profiles. *Id.*; Restatement (Third) of Trusts § 227 cmts. g & h. In general terms, this is what it means to diversify an investment portfolio.

By statutory design, an ESOP's investment portfolio is *un*diversified, consisting entirely or almost entirely of one security – stock of the employer. If a retirement plan were likewise invested solely in a single issue of common stock, selected only because it was the employer's common stock, it would always be "imprudently" invested, because the risk inherent in nondiversification would be too great and the selection criteria for the stock's inclusion inadequate. ERISA's exception to the duty to diversify exists to accommodate ESOPs and allow their fiduciaries to follow the plan's terms without violating the law.

B. The Government's Approach Is Unworkable.

The Government and plaintiffs in ERISA stock drop cases contend that, notwithstanding the inherent imprudence of investing solely in a high-risk asset like a single issue of stock (which the statute allows), ESOP fiduciaries have a duty to monitor the stock's volatility and intervene if it crosses some (unspecified) threshold of greater risk. The Court should reject this unworkable formulation of the duty of prudence. Instead, it should either recognize that ERISA's duty of prudence does not impose an obligation on the part of an ESOP fiduciary to act in response to changes in price of the publicly traded employer stock held by the plan, or adopt the "robust" *Moench* presumption advocated by Petitioners.

First, the Government's approach ignores the character of ESOPs and the nature of the risk that the statute necessarily anticipates and authorizes for them. It ignores the critical fact that the risks at issue in most of the ERISA stock drop cases are diversifiable risks that the fiduciary was excused from having to diversify in the first place. It ignores that the duty to diversify exists in important part precisely because of the virtual impossibility of reliably making ultrafine judgments about the likelihood of a stock's future course and the excessive costs of trying to do so. Restatement (Third) of Trusts § 227 cmt. f. *See* Longstreth, Modern Investment Management and the Prudent Man Rule 81-85.

Second, it assumes that the duty to monitor and replace securities that have become excessively risky works the same way for an undiversified portfolio as it does for a regular diversified portfolio. It does not. In a diversified portfolio, the consequence of such a change is small and does not affect the character of the portfolio. Judgments are rough and relatively inexpensive. But in an ESOP portfolio, the change is hugely consequential. It alters the character of the ESOP. It requires the fiduciary to perform the impossible job of finding and then occupying the infinitesimal space that theoretically lies between an undiversified portfolio invested in common stock which, apart from its lack of diversification, is "prudent" (*i.e.,* very risky but not *too* risky) and an undiversified portfolio invested in common stock that, apart from its lack of diversification, is "*im*prudent" (just too risky). *See, e.g., White,* 714 F.3d at 987 (describing this space as "razor's edge"). Entrepreneurial plaintiffs' lawyers do not much care which way the fiduciary's judgment falls. In the Sixth Circuit and under the Government's approach, they get the cudgel of a trial either way – if the share price drops, they sue for waiting too long to act; if the share price recovers and rises, they get to sue for selling too soon. *See Rinehart v. Akers,* 722 F.3d 137, 140-41 (2d Cir. 2013) (drop); *Bunch v. W.R. Grace,* 555 F.3d 1, 2-3 (1st Cir. 2009) (rise). These are the ingredients that propel big-dollar settlements and, if effectively baked into every case by adoption of the Government's proposed rule, almost surely would lead to the demise of ESOPs. That may be what the government has in mind,[10] notwithstanding the favored treatment Congress has afforded ESOPs.[11]

Third, even the standards adopted in the robust presumption circuits, while better, do not bring great clarity in cases where the company's drama is high enough to approach the threshold for rebutting the presumption. For example, identifying when the circumstances "clearly implicate the company's viability as an ongoing concern," or when the situation is sufficiently "dire," so as to require the fiduciary to

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[10] *See, e.g.*, Virginia Smith, Director of Enforcement, Employee Benefits Security Administration, U.S. Department of Labor, Comments at American Society of Pension Professionals and Actuaries ("ASPPA") 2010 Los Angeles Benefits Conference ("A second national enforcement project that we've had for a couple of years now is Employee Stock Ownership plans. . . . This is an area that is rife with problems from our perspective. I suppose there's some good ones out there. If anybody knows of any let me know. I've yet to find one."); *id.*, Comments at ASPPA 2011 Los Angeles Benefits Conference ("I have never seen a good ESOP.").

[11] *See, e.g.*, Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h) ("The Congress, in a series of laws . . . has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trust and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans…").

override the plan's terms is not clear. How dire do circumstances have to be? If the plan provides for maintenance of the investment "no matter how dire the circumstances," that would seem to remove the decision from challenge altogether. But the Government argues that ERISA's prudence standards trump inconsistent plan terms, *see* 29 U.S.C. § 1104(a)(1)(D), a proposition with which even the most vigorous presumption of prudence circuits do not seem to disagree. *E.g., White,* 714 F.3d at 997. That brings us back to trying to determine where the line of ERISA prudence falls and the seeming impossibility of doing so.

These points together, and the bar's experience with more than 19 years of litigating these cases, counsel toward recognizing that ERISA's duty of investment prudence does not require ESOP fiduciaries to act in response to price swings of the publicly traded employer stock held by the plan. The standards by which judgments are to be made in these cases are much too nebulous to serve as the basis for imposing liability on fiduciaries for "wrong" decisions. Recognizing the inappropriateness of imposing a duty to act in these cases is also compelled by the structure of the statute, which not only gives license for these unusual plans, but also ensures that participants have freedom to move their contributions in and out of employer stock funds (such as the Fifth Third stock fund) whenever the stock's volatility exceeds the participant's risk threshold. *See* 29 U.S.C. § 1054(j) (requiring that participants be permitted to freely transfer their own contributions out of employer stock fund and move employer contributions freely after three years of service); *White,* 714 F.3d at 993-94.

It is not as if the risk of loss or even bankruptcy is not contemplated and accepted by the ESOP rules. For ESOPs holding shares of nonpublicly traded companies, there generally is no market for the shares. If conditions deteriorate at the plan sponsor, there generally is no market for the employer shares held by the ESOP. That is one of the risks of ownership that the statute does not attempt to mitigate. Even assuming the ESOP's fiduciary could find a buyer for the stock, she will be sitting on the same "razor's edge" as the ESOP holding publicly traded employer securities.

II. THE COURT SHOULD MAKE CLEAR THAT THE DUTY OF INVESTMENT PRUDENCE FOR ESOPS HOLDING PUBLICLY TRADED SHARES DOES NOT REQUIRE VIOLATION OF THE SECURITIES LAWS.

The Court should make clear that the duty of prudence governing ESOP fiduciaries does not require violation of the securities laws.

The Government appears to agree that ESOP fiduciaries have no duty to use material nonpublic inside information to sell "artificially inflated" stock for the benefit of ESOP participants, U.S. Cert. Br. at 12, but Respondents do not agree. There should be little doubt that ERISA does not require fiduciaries to violate securities laws by engaging in insider trading, and the Court should expressly so hold. *Rinehart v. Akers,* 722 F.3d 137, 147 (2d Cir. 2013); *Kopp,* 722 F.3d at 339-40.

The Government suggests that ESOP fiduciaries with inside information indicating that the employer's stock is "artificially inflated" may have a duty to publicly disclose the information to protect participants from overpaying. U.S. Cert. Br. at 12 (citing *Kopp,* 722 F.3d at 340 and *Harris v. Amgen, Inc.,* 738 F.3d 1026, 1041-42 (9th Cir. 2013). But in the typical case, the share price of the stock would immediately be adjusted downward by the market to account for the new information, and the air in the stock would immediately escape. The government does not explain how this would help participants.

The cases cited by the Government appear to be of no or little help. *Kopp* expressly declined to find that ERISA's prudence rule imposed a general duty to disclose all adverse inside information to the public, holding that "it is not the province of the courts to create such a duty out of whole cloth," and citing a Seventh Circuit decision that also declined to find a duty to disclose corporate well-being out of concern not to "disturb[] the carefully delineated corporate disclosure laws"). *Id.* (citing, *inter alia*, *Baker v. Kingsley,* 387 F.3d 649, 662 (7th Cir. 2004)). Fifth Circuit cases recognizing a duty of disclosure have been limited to situations where participants requested copies of plan documents in connection with their claims for benefits. *Id.* (citing *Kujanek v. Houston Poly Bag I, Ltd.,* 658 F.3d 483, 488 (5th Cir. 2011)). Other cases have reached the same result. *In re Citigroup ERISA Litig.,* 662 F.3d at 144-45; *Lanfear v. Home Depot, Inc.,* 679 F.3d 1267, 1284-85 (11th Cir. 2012); *Edgar,* 503 F.3d at 350 (discussing unhelpful economic consequences that disclosing such information would have).

The Ninth Circuit in *Harris v. Amgen* found that there was a duty to disclose, but grounded that duty in the fact that ERISA fiduciary defendants were the same individuals who allegedly violated securities laws by making misleading statements. The court reasoned that, because the defendants had a duty under the securities laws to correct their misstatements, separately requiring them under ERISA to make the same corrective disclosures would not have caused them to violate any securities laws. Had defendants made such disclosures promptly, the share price would not have been significantly inflated. *Harris v. Amgen,* 738 F.3d at 1041-42.

III. ESOPS HAVE BEEN FAVORED UNDER THE LAW SINCE 1953 AND HAVE BEEN PROVIDING SOCIETAL BENEFITS EVER SINCE.

Congress has repeatedly and emphatically endorsed ESOPs for a reason – their long and rich history of providing the benefits of employee ownership to workers.

A. A Brief History of ESOPS.

In 1953, the Internal Revenue Service published a ruling for the first time allowing corporations to use stock bonus or profit-sharing plans to borrow money for investments in company stock. *See* Elana Ruth Hollo, *The Quiet Revolution: Employee Stock Ownership Plans and Their Influence on Corporate Governance, Labor Unions, and Future American Policy*, 23 Rutgers L.J. 561, 563 n.9 (1992). This ruling permitted "a key element of ESOPs, leveraging, which allows employees to purchase stock in their own company without putting up any of their own capital." *Id.* Following this ruling, in 1954 San Francisco lawyer and economist Louis O. Kelso established the first equivalent of an ESOP at Peninsula Newspapers, Inc. *See* Dana M. Muir, *The U.S. Culture of Employee Ownership and 401(k) Plans*, 14 Elder L.J. 1, 6 (2006); Steven J. Arsenault, *Aesop and the ESOP: A New*

Fable About Dividends and Redemptions, 31 Va. Tax Review 545, 548 n.9 (2012). Kelso would go on to become a strong advocate for the formation of ESOPs, arguing for broad-based employee stock ownership as one way to create a more vibrant capitalist system. *See* Louis O. Kelso & Mortimer J. Adler, *The Capitalist Manifesto* 169-70 (1958).

In 1973, Kelso met with Senator Russell Long (D-LA), then Chairman of the Senate Finance Committee, to discuss the benefits of employee stock ownership. *See* Corey M. Rosen et al., Employee Ownership in America 15 (1986). The day after this meeting, Senator Long inserted the first Congressional endorsement of ESOPs into the Regional Railroad Reorganization Act of 1973. *See id.* at 60-61; Regional Rail Reorganization Act of 1973, Pub. L. No. 93-236, §§ 102(5), 301(e), 87 Stat. 985, 987, 1005 (1974) (sponsoring a study of employee ownership of the new national rail system, Conrail). Senator Long would become "a champion of ESOP legislation, leading hearings and speaking fervently on its behalf whenever the opportunity arose." Hollo, *supra*, 23 Rutgers L.J. at 564.

The following year, recognition of ESOPs as a favored form of stock bonus plan in ERISA was a watershed event that led to the proliferation of employee stock ownership plans throughout the country. *See* Michel E. Murphy, *The ESOP at Thirty: A Democratic Perspective*, 41 Willamette L. Rev. 655, 656 (2005). "A number of divergent interest groups acted together to create the 'broad bipartisan support' needed to secure the inclusion of ESOP provisions in ERISA. Political conservatives who viewed ESOPs as a means to strengthen the free-market system, as well as those concerned with growing economic inequality and its implications for democracy, supported the ESOP plan. ESOPs were also supported by those concerned with the lack of investment in, and the de-industrialization of, the U.S. economy, along with those who supported worker ownership for ideological reasons." Hollo, *supra*, 23 Rutgers L.J. at 566. In drafting and adopting the ESOP provisions of ERISA, Congress expressly intended to encourage employees' ownership of their employer company and the formation of ESOPs. *See Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983); *Kuper v. Iovenko*, 66 F.3d 1447, 1458 (6th Cir. 1995); H.R. Rep. No. 92-1280, at 58 (1974) (Conference Report) 1974 U.S.C.C.A.N. 5038, 5097 ("Any diversification principle that may develop in the application of the prudent man rule is not to restrict investments by [ESOPs] in qualifying employer securities.").

Over the next two decades, Congress passed some twenty-five bills promoting and elaborating upon its express policy to encourage employees' ownership of their employer company and the formation of ESOPs. *See* Jeff Gates, The Ownership Solution, Toward a Shared Capitalism for the Twenty-First Century 53 (1998). *See also, e.g.,* Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975) (providing ESOPs with corporate tax credit); Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1590 (1976) (increasing allowable tax deductions for ESOP contributions); Economic Recovery Tax Act, Pub. L. No. 97-34, 95 Stat. 172 (1981) (making interest paid on loans from ESOP fully deductible); Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984) (providing tax incentives for lenders making loans to ESOPs and tax deductions for dividends passed through to ESOP participants); Small Business Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (1996) (permitting S corporation shareholders to participate in ESOPs); Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001) (expanding provisions allowing deductions for dividends paid on reinvested ESOP stock); American Job Creations Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004) (permitting S corporations to use distributions on stock held by plan to repay loans used to acquire stock).

Today, ESOPs serve a variety of purposes in the corporate context. "The ESOP's primary purpose . . . is not to serve as a retirement vehicle but, rather, to serve as an incentive for corporations to structure their financing in such a way that employees can gain an ownership stake in the company for which they work." 129 Cong. Rec. S16, 637 (daily ed. Nov. 17, 1983) (statement of Sen. Long).

B. The Benefits of ESOPS.

ESOPs play a significant role in increasing the total compensation and retirement contributions for employees of companies who sponsor them. According a 2008 study by E. Han Kim of the University of Michigan and Page Ouiment of the University of California, companies sponsoring ESOPs compensate their employees approximately 4.5% more than companies without. *See* Corey Rosen, *Employee Ownership and Corporate Performance A Review of Research on U.S. Companies,* at 22, 27 (2011*), availa ble a*t http://www.nceo.org/Employee-Ownership-Corporate-Performance/pub.php/id/50/. A 2010 study funded by the Employee Ownership Foundation and based on data from the U.S. Department of Labor's Form 5500, which all companies with ERISA plans must file, found that companies sponsoring ESOPs provide more employee benefits than non-ESOP companies, with approximately 56 percent of companies sponsoring ESOPs offering a second retirement savings or defined contribution plan. *See* The ESOP Association, Employee Ownership & Corporate Performance, http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters#statistics (last visited Feb. 1, 2014). The same study reported that ESOP-sponsoring companies contributed 75 percent more to their ESOPs than what non-ESOP companies contributed to their primary retirement plans. *Id*. In fact, the average company sponsoring an ESOP contributed $4,443 per year to their primary retirement plan on behalf of each active participant, whereas the average non-ESOP company with a defined contribution plan contributed an estimated $2,533 per active participant. *Id*.

Companies sponsoring ESOPs also realize advantages in employee productivity and corporate performance. For example, the turnover rate of workers with employee stock ownership is significantly lower than that of employees without employee stock ownership. *See* The ESOP Association, Employee Ownership & Corporate Performance, http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters#statistics (last visited Feb. 1, 2014) (figures as of 2010). Data from the 2010 General Social Survey showed that 13% of the employees with employee stock ownership intended to leave their companies in the coming months, as compared to a rate of 24% of employees without employee stock ownership. *Id*. In addition to greater employee retention, employee ownership of his or her employer's stock results in increased job satisfaction as well as increased corporate productivity and profitability. *See* Steven F. Freeman, *Effects of ESOP Adoption and Employ*

Ownership: Thirty Years of Research and Experience, at 7 (January 4, 2007), *available at* http://repository.upenn.edu/od_working_papers/2/. In closely held companies, adoption of an ESOP also tends to increase overall sales, number of employees, and sales per employee by about 2.3 to 2.4 percent annually over what would be expected if no ESOP were in place. *See* The National Center for Employee Ownership, Research on Employee Ownership, Corporate Performance, and Employee Compensation, http://www.nceo.org/articles/research-employee-ownership-corporate-performance (last visited Feb. 2, 2014). Taken on their own, these differentials might appear insubstantial. Projected over ten years, however, a company sponsoring and ESOP is estimated to be one-third larger than its non-ESOP counterpart. *See* Corey Rosen, *The State of the Broad-Based Employee Ownership Plans*, at 12 (2013), *available at* http://www.nceo.org/State-Employee-Ownership-ebook/pub.php/id/275/. Finally, companies sponsoring ESOPs enjoy greater longevity than non-ESOP companies and are substantially more likely than their competitors to be in business several years later. *Id.* at 11.

Adoption of ESOPs even saved the federal government money during the Great Recession. Using data from the 2010 General Social Survey, an analysis by the National Center for Employee Ownership showed that employee stock owned companies laid off employees at a rate of 2.6% in 2010, whereas the rate for conventionally-owned companies was 12.1%. *See* The ESOP Association, Employee Ownership & Corporate Performance, http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters#statistics (last visited Feb. 2, 2014). The NCEO analysis calculates that 18 million Americans worked for employee stock owned companies in 2010, with 11 million working in companies with ESOPs. *See id.* Savings to the federal government from the low layoff rate of ESOP participants was $13.7 billion in 2010, or almost 14 times the estimated $1 billion a year tax expenditure attributed to the special laws promoting ESOP creation and operation. *See id.*

CONCLUSION

For all of the foregoing reasons, the judgment of the court of appeals should be reversed.

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