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February 26, 2014

VIA HAND DELIVERY AND ELECTRONIC MAIL

Ms. Denise McNerney, Merits Cases Clerk
Supreme Court of the United States
One First Street, N.E.
Washington, D.C. 20543

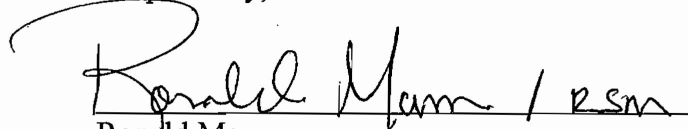
Re: *Fifth Third Bancorp, et al. v. John Dudenhoeffer, et al.*, No. 12-751

Dear Ms. McNerney:

Pursuant to United States Supreme Court Local Rule 32.3, Respondents John Dudenhoeffer and Alireza Partovipanah submit to the Clerk of the Court Peter Wiedenbeck's *Trust Variation and ERISA's Misbegotten "Presumption of Prudence*," to be published in Tax Notes in mid-March 2014. Respondents cite to this as-of-yet unpublished article in their brief on the merits and enclose herewith a copy of this article for the convenience of the Court.

All Counsel of Record will receive a copy of the enclosed article as well.

Respectfully,



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cc: Counsel of Record (via Federal Express and electronic mail)

Trust Variation and ERISA's Misbegotten "Presumption of Prudence"

Peter J. Wiedenbeck

Peter Wiedenbeck is Joseph H. Zumbalen Professor of the Law of Property at Washington University in St. Louis. He is the author of ERISA: PRINCIPLES OF EMPLOYEE BENEFIT LAW (Oxford Univ. Press 2010), and CASES AND MATERIALS ON EMPLOYEE BENEFITS (West Academic Pub. 2013) (with Russell K. Osgood), as well as numerous articles, including *Invisible Pension Investments*, 32 VA. TAX REV. 591 (2013) (with Rachael K. Hinkle & Andrew D. Martin). In this article, Wiedenbeck provides the perspective of an employee benefit and tax law scholar on fiduciary breach claims brought in ERISA stock drop litigation, and critically evaluates the propriety of the so-called *Moench* presumption of prudence. The issue is pending before the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer*, 692 F.3d 410 (6th Cir. 2012), *cert. granted*, 82 U.S.L.W. 3362 (U.S. Dec. 13, 2013) (No. 12-751), which is set for oral argument on April 2, 2014.

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Trust Variation and ERISA's Misbegotten "Presumption of Prudence"[†]

Peter J. Wiedenbeck[*]

I. Introduction

The U.S. Department of Labor reports that single-employer defined contribution pension plans with 100 or more participants held, directly or indirectly, $315 billion in employer securities in 2010, or about 9.7% of the plans' total gross assets of $3,234 billion.[1] A very large share of these employer securities, more than $202 billion, was held by employee stock ownership plans (ESOPs).[2] ESOPs are designed to invest primarily in employer stock, and so these holdings are largely undiversified.[3] The Employee Retirement Income Security Act of 1974 (ERISA),[4] allows certain types of defined contribution pension plans—which are also called individual account plans[5]—to make concentrated investments in the employer. In addition to an ESOP, a profit-sharing or stock bonus plan that explicitly authorizes the acquisition or holding of certain employer securities or employer real property is ordinarily classified as an "eligible individual account plan" (EIAP).[6] An EIAP is eligible to dispense with diversification: it can invest in specified types of employer securities or real property regardless of the general fiduciary duty to diversity plan investments, and is also excused from ERISA's outright ban on investing more than 10 percent of the fair market value of plan assets in employer securities and real property.[7] EIAP fiduciaries are *not* excused from their duties to act "solely in the interest of

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1 EMPLOYEE BENEFITS SECURITY ADMINISTRATION (EBSA), U.S. DEPARTMENT OF LABOR, FORM 5500 DIRECT FILING ENTITY BULLETIN: ABSTRACT OF 2010 FORM 5500 ANNUAL REPORTS Table 11 at 11 (2013), at http://www.dol.gov/ebsa/pdf/directfilingentity2010.pdf. A substantial share of these employer securities, about 22%, was owned indirectly through plan investments in various direct filing entities, particularly master trusts. *Id.* Table 12, Table 2 (master trusts account for virtually all indirect holdings of employer securities). For an explanation of the types of indirect investment vehicles utilized by pension plans, an overview of their holdings, and an analysis of the relationship between direct and indirect pension plan investments, see Peter J. Wiedenbeck et al., *Invisible Pension Investments*, 32 VA. TAX REV. 592 (2013).

2 EBSA, PRIVATE PENSION PLAN BULLETIN: ABSTRACT OF 2010 FORM 5500 ANNUAL REPORTS Table D14 at 61 (2012), at http://www.dol.gov/ebsa/PDF/2010pensionplanbulletin.PDF. The number is more than the $202 billion because that figure includes only direct plan investments; ESOPs reported another $329 billion held in master trusts, some portion of which consists of employer stock owned by master trusts.

3 ERISA § 407(d)(6), 29 U.S.C. § 1107(d)(6) (2006); I.R.C. § 4975(e)(7); Treas. Reg. § 54.4975-11.

4 Pub. L. No. 93-406, 88 Stat. 829 (1974).

5 ERISA § 3(34), 29 U.S.C. § 1002(34).

6 ERISA § 407(d)(3), 29 U.S.C. § 1107(d)(3). To qualify as an EIAP the benefits provided under the ESOP, profit-sharing, or stock bonus plan must not be taken into account in determining the benefits under a defined benefit plan (i.e., a traditional pension plan).

7 ERISA §§ 404(a)(2), 407(b)(1), 29 U.S.C. §§ 1104(a)(2), 1107(b)(1).

[plan] participants and beneficiaries" for the "exclusive purpose of providing benefits to participants and their beneficiaries;" and they are generally obliged to act prudently.[8] When an ESOP or other EIAP suffers large losses on its employer stock holdings, participants often bring suit claiming violation of these abiding duties of loyalty or reasonable care. Such "stock drop" litigation was particularly prevalent in the aftermath of the sharp stock price declines of 2008. For the most part, disappointed workers have gotten no relief, as their claims have been met with a presumption that continued investment in company stock is reasonable absent proof of impending collapse or other extremely dire circumstances.

This "presumption of prudence" originated with:[9]

> *Moench v. Robertson*,[10] a suit for breach of fiduciary duties by former ESOP plan participants against members of the plan committee. The committee had continued to invest plan contributions in stock of the employer bank throughout a two-year period during which federal bank regulators repeatedly expressed concern about the financial condition of the bank and the stock price plummeted from $18.25 to pennies per share. Defendants, who were corporate directors as well as members of the plan committee, argued that even in that situation investing solely in employer stock was permissible due to the special nature of an ESOP. Because Congress intended the ESOP to be both an employee retirement benefit plan and a technique of corporate finance that would encourage employee ownership,[11] the Third Circuit concluded that neither goal should prevail to the exclusion of the other. In limited circumstances, therefore, "ESOP fiduciaries can be liable under ERISA for continuing to invest in employer stock according to the plan's direction".[12] To accommodate the ESOP's competing purposes, the court held that an ESOP fiduciary who invests assets in employer stock is entitled to a presumption that it acted consistently with ERISA, but the plaintiff may overcome that presumption by introducing evidence that, owing to circumstances that the settlor did not know nor anticipate, continuing to invest in employer stock would defeat or substantially impair the accomplishment of the plan's purpose to provide workers retirement savings.[13]
>
> The Third Circuit subsequently concluded that the *Moench* rationale is not limited to ESOPs, but applies as well to other types of [EIAPs], including plans that call for participant-directed investments. Specifically, *Edgar v. Avaya, Inc.* concerned a participant-directed 401(k) plan, the terms of which required that an employer stock fund be among the available investment alternatives.[14]

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[8] ERISA §§ 404(a), 29 U.S.C. § 1104(a). Prudence, however, is not demanded "to the extent that it requires diversification".

[9] The following quotation comes from PETER J. WIEDENBECK, ERISA: PRINCIPLES OF EMPLOYEE BENEFIT LAW 148-49 (2010) (original footnotes retained and renumbered).

[10] 62 F.3d 553 (3d Cir. 1995).

[11] *Id.* at 569.

[12] *Id.* at 556.

[13] *Id.* at 571.

[14] 503 F.3d 340, 343, 347 (3d Cir. 2007).

The *Moench* presumption, as it is called, has now been adopted by six other circuits,[15] but the opinions generally fail to address the premises and scope of rule. Moreover, "thus far no consensus has developed on how dire the employer's prospects must become to render continued investment in employer stock imprudent."[16]

II. *Moench* and Traditional Trust Variation

Moench attempts to resolve the conflict between multiple plan objectives when the goals of employee ownership and employee retirement security become incompatible. The standard announced by the Third Circuit was taken from the rule on administrative deviation in the Second Restatement of Trusts, which provides in part:

> The court will direct or permit the trustee to deviate from the terms of the trust if owing to circumstances not known to the settlor and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the trust; and in such case, if necessary to carry out the purposes of the trust, the court may direct the trustee to do acts which are not authorized or are forbidden by the terms of the trust.[17]

The *Moench* court, unfortunately, provided an erroneous citation for this rule.[18] Perhaps for that reason, most of the ERISA cases have failed to recognize or engage with its trust law origins.[19]

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[15] White v. Marshall & Ilsley Corp., 62 F.3d 553, 988-91 (7th Cir. 2013); Lanfear v. Home Depot, Inc., 679 F.3d 1267, 1281 (11th Cir. 2012); In re Citigroup ERISA Litigation, 662 F.3d 128 (2d Cir. 2011); Quan v. Computer Scis. Corp., 623 F.3d 870, 881 (9th Cir. 2010); Kirshbaum v. Reliant Energy, 526 F.3d 243, 254 (5th Cir. 2008); Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995).

[16] WIEDENBECK, *supra* note 9, at 149. The quoted language is accompanied by the following footnote:

> *Edgar*, 503 F.3d at 349 n. 13 ("We do not interpret *Moench* as requiring a company to be on the verge of bankruptcy before a fiduciary is required to divest a plan of employer securities."); Lalonde v. Textron, Inc., 369 F.3d 1, 6 (1st Cir. 2004) (because the "important and complex area of law implicated by plaintiffs' claims is neither mature nor uniform . . . we believe that we would run a very high risk of error were we to lay down a hard-and-fast rule"); Brieger v. Tellabs, Inc., 2009 U.S. Dist. LEXIS 49747, at *37 (N.D. Ill. June 1, 2009) (leaving open whether the standard is "impending collapse or something short of that"); In re Ford Motor Co. ERISA Litigation, 590 F. Supp. 2d 883, 892-93 (E.D. Mich. 2008) (rejecting the "imminent collapse standard in favor of a rule requiring divestiture "at the point at which company stock becomes so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would invest any plan assets in it, regardless of what other stocks were also held in the plan's portfolio").

[17] Restatement (Second) of Trusts § 167(1) (1959). Further, § 167(2) says that where the trustee reasonably believes there is an emergency he may deviate from the terms of the trust without first obtaining judicial authorization.

[18] After announcing the presumption that ESOP investments in employer stock are consistent with ERISA's fiduciary duties, the *Moench* opinion observes that "In attempting to rebut the presumption, the plaintiff may introduce evidence that 'owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.' Restatement (Second) § 227 comment g." 62 F.3d at 571. The quoted language, however, actually appears in comment q to Restatement (Second) of Trusts § 227. Even the correct comment is not the primary authority, it simply parrots the wording of the operative rule, § 167(1) of the Second Restatement. Compounding confusion, *Moench* quotes and cites Restatement (Third) of Trusts § 228. Only a few provisions of the Third Restatement,

The almost unthinking importation of traditional trust variation principles into ERISA elides several serious difficulties. The automatic assumption that the employer sponsoring an EIAP is the "settlor" of the pension trust is one problem. Even if the plan sponsor may be treated as settlor, *Moench* and its progeny overlook an essential premise of the Second Restatement's administrative deviation rule: it would not apply to a private trust that is amendable in the way that a pension trust is required to be.

A. Trust Variation and Tax Qualification

Administrative deviation is designed to promote the accomplishment of the settlor's objectives by relieving the trustee of restrictions on her managerial authority in situations where an unexpected change has brought those restrictions into conflict with the core purposes of the trust.

> [T]he court in conferring power on the trustee is attempting to prevent the failure or substantial impairment of the purpose for which the settlor created a trust. It is permitting the trustee to do not what the settlor intended to permit him to do but what it thinks the settlor would have intended to permit if he had known of or anticipated the circumstances that have happened. Even though the settlor has expressly forbidden what the court permits to be done, the theory is that he would not have forbidden it, but on the contrary would have authorized it if he had known of or anticipated the circumstances. In so doing the court is not interpreting the terms of the trust but is permitting a deviation from them in order to carry out the purpose of the trust.[20]

The obligation to invest in employer stock (whether imposed directly by the plan's terms or indirectly by participant direction) is a restriction on a plan trustee's power that can undermine the goal of accumulating adequate retirement saving if the employer's financial health is in jeopardy. For that reason, administrative deviation offers an enticing framework for addressing the competition between employee ownership and retirement security under ERISA.

The purposes of the trust, of course, are the settlor's purposes, just as it is the settlor's understanding (i.e., whether threatening circumstances were then known or anticipated) that circumscribes the scope of administrative deviation. *Moench* and its followers proceed on the assumption that the employer sponsoring the plan is settlor of the pension trust, but it's not necessarily so.

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those relating to the prudent investor rule, were available when *Moench* was decided, but one of those, Restatement (Third) of Trusts § 228 cmt. e (1992), paraphrases the distributive deviation rule and cites § 167 of the *Second* Restatement. When the Third Circuit subsequently extended the *Moench* presumption to other types of eligible individual account plans, it repeated the mistaken citation to comment g of the Second Restatement. *Edgar*, 503 F.3d at 348.

[19] But see Lanfear v. Home Depot, Inc., 679 F.3d 1267, 1281 (11th Cir. 2012); In re McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812, 830 n.16 (N.D. Cal. 2005).

[20] IIA AUSTIN W. SCOTT & WILLIAM F. FRATCHER, SCOTT ON TRUSTS § 167, at 287-88 (4th ed. 1987) [hereinafter SCOTT ON TRUSTS].

The settlor is the person who creates the trust.[21] Creation of an inter vivos trust is typically accomplished by transferring legal ownership of property to another person to manage the property or its proceeds as trustee for the benefit of the transferor or a third person.[22] Ordinarily the transferor also sets the terms of trust, but a property owner may transfer property on terms established by another person, and in that instance the owner-transferor is the settlor of the trust, not the drafter of the instrument. It is even possible to transfer property to a trustee subject to the terms of a preexisting trust established by someone else (e.g., a spouse or other family member), and in that case the trust has multiple settlors.[23]

Analogously, a plan sponsor does not become settlor of the associated pension trust by specifying the terms of the program. Instead, anyone who contributes to the fund is a settlor, presumably including employees who make elective deferrals under a 401(k) plan or similar salary reduction arrangement.[24]

Formally, of course, the employer corporation is owner of the funds contributed to the plan. But where those contributions are made pursuant to a cash-or-deferred arrangement or other salary reduction authorization, the employer is merely acting as agent for those employees who choose to direct a portion of their pay into the retirement savings program. When it comes to nonelective or employer matching contributions, the company seems to be committing its own resources to the pension plan, and so to that extent could be viewed as settlor. Yet the lesson of the tax law nondiscrimination rules, properly understood, is that ostensible employer financing of qualified retirement plan savings is a ruse.[25] The system is financed by employee participants who forego a portion of their current compensation (or future pay increases) in exchange for "employer" contributions, and by the enormous tax subsidy associated with the preferential tax treatment accorded qualified plan savings.[26] Plan sponsorship is voluntary, and in a competitive labor market an employer will not offer a plan that entails an overall net compensation cost increase.[27] Therefore, a pension, profit-sharing, or stock bonus plan that is formally funded exclusively by required employer contributions is in substance paid for by covered workers (via reduced take-home pay) with the assistance of other American taxpayers. If one attends to the

[21] RESTATEMENT (THIRD) OF TRUSTS § 3(1) (2003).

[22] *Id.* § 10(b).

[23] UNIF. TRUST CODE § 103(15) (2000) ("If more than one person creates or contributes property to a trust, each person is a settlor of the portion of the trust property attributable to that person's contribution . . . .").

[24] I.R.C. §§ 403(b) (annuity plans for public school and charitable organization employees), 408(p)(2)(A) (simple retirement plans for small employers), 457(b) (eligible deferred compensation plans for state and local government and tax-exempt organization employees).

[25] *See generally* WIEDENBECK, *supra* note 9, at 20-23, 303-11. Bruce Wolk, *Discrimination Rules for Qualified Retirement Plans: Good Intentions Meet Economic Reality*, 70 Va. L. Rev. 419, 429–33 (1984).

[26] According to the Treasury, the net cost of the preferential treatment of qualified retirement plans (including 401(k) plans and Keogh plans, but excluding individual retirement accounts) is projected to be approximately $145 billion in fiscal year 2013. Executive Office of the President, Analytical Perspectives, Budget of the United States Government, Fiscal Year 2013, Table 17-2 at 258 (2012), available at http://www.gpo.gov/fdsys/pkg/BUDGET-2013-PER/pdf/BUDGET-2013-PER.pdf. Going by congressional estimates, the figure is only $101 billion. Staff of the Joint Comm. on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017, at 39 (2013), available at https://www.jct.gov/publications.html?func=startdown&id=4504.

[27] *See* WIEDENBECK *supra* note 9, at 18-19.

incidence of the economic burden of qualified plan saving, the sponsoring employer corporation is not in any real sense a settlor of the pension trust. The company has no skin in the game.

The significance of this insight is that the expectations or purposes of the employer sponsoring an ESOP or other EIAP should have no immediate bearing on the availability of administrative deviation once continued investment in employer stock comes to jeopardize workers' retirement savings. However highly the company may prioritize the goal of employee ownership, no firm assets are at stake, so it's not their call. More precisely, it's not *directly* the company's call. The corporation, of course, writes the plan, and therefore sets the terms under which employees choose to contribute (whether by authorizing elective deferrals or simply by continuing to work for the sponsor). Plan terms clearly require or permit undiversified investment in employer stock, and under ERISA's disclosure regime a settlor-employee should be credited with basic awareness of the conflicted goals of the plan. To that extent the sponsoring company *indirectly* fixes the equity court's agenda upon a request for administrative deviation. When push comes to shove, however, the "purposes of the trust" should be determined by reference to settlor-employees' understanding of the plan, based on the summary plan description (SPD) and other accessible disclosure documents, not the detailed, technical and secret understanding of the employer-sponsor.[28] That distinction is important, because the average worker is not an investment professional; abstract notice about the riskiness of undiversified investments in employer stock, delivered when the business is flying high, will not be internalized as "you'll be betting your retirement on a long shot and we won't let you cash in your chips." Once the employer falls on hard times and the conflicting goals of the plan become salient, an employee will prioritize her interest in a comfortable retirement over employee ownership, and that participant-centered perspective casts a very different light on the "purposes of the trust" than if the sponsoring employer is treated as settlor.

The purposes of the trust should also be evaluated from the standpoint of U.S taxpayers as co-settlors. Taxpayer contributions are made pursuant to their representatives' decision to subsidize employee ownership despite the risk to retirement security. From one perspective, taxpayers might be deemed to share Congress' purposes in allowing undiversified investment in the corporate employer. If so, taxpayer interests add nothing new to the analysis. The problem of accommodating the purposes of Congress (and taxpayer-contributors) when employee ownership and retirement security objectives come into conflict is just a question of statutory construction (not *plan* interpretation). Admittedly, it's a murky, difficult question, but it can be informed by reviewing the long history of tax subsidies for employee ownership of employer stock.[29] Alternatively, by focusing on agency costs (adopting a public choice view of legislative action) taxpayer interests might be seen to diverge from congressional priorities. From that perspective, the dubious economic case for subsidized employee ownership,[30] combined with the prospect of

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[28] ERISA § 102, 29 U.S.C. § 1022 (SPD must be "written in a manner calculated to be understood by the average plan participant, and shall be sufficiently accurate and comprehensive to reasonably apprise such participants and beneficiaries of their rights and obligations under the plan"); 29 C.F.R. § 2520.102-3 (SPD contents). The question of the binding effect of the SPD and inferences drawn therefrom is explored in WIEDENBECK *supra* note 9, at 65-83. *But see* Cigna Corp. v. Amara, 563 U.S. ___, 131 S. Ct. 1866 (2011) (SPD is not the plan).

[29] *See infra* Part IV.A.

[30] See Summers v. State St. Bank & Trust Co., 453 F.3d 404, 410 (7th Cir. 2006), in which Judge Posner observed:

additional tax burdens presented by impoverished worker-capitalists, unambiguously supports recognition of a taxpayer-settlor preference for retirement security once the corporate sponsor falls on hard times.

B. Amendment Authority

The operation of the traditional administrative deviation standard depends on the settlors' objectives, as explained above. In addition, the rule is premised on the need for *judicial* intervention. If the settlor possesses the power to modify the trust to respond to a change in circumstances, then the trustee has no need to petition the equity court for revision of trust terms.[31] ERISA demands that every employee benefit plan "provide a procedure for amending such plan, and for identifying the persons who have authority to amend the plan".[32] In the case of a single-employer plan, amendment authority (which is commonly called a "settlor function" in ERISA opinions addressing the scope of fiduciary responsibilities) is invariably assigned to the employer-sponsor or a representative thereof. The plan sponsor could therefore intervene to lift the employer stock investment restriction (or preference) and so require diversification. Hence the glib assumption that the employer corporation is settlor of the pension trust is at odds with recourse to administrative deviation to protect the "settlor's purposes". The employer sponsoring an ESOP or EIAP can fix the problem if it sees a need to do so, and if it does not take steps to authorize diversification, then there is clear-cut evidence of the ostensible settlor's actual purposes under current conditions: namely, the "settlor" continues to privilege employee ownership over retirement security. Ironically, if the plan sponsor were properly characterized as settlor, as the *Moench* line of cases assumes, then the trust law analogy indicates that administrative deviation would not apply, and even if it did, the petition for revision of the plan terms (lifting the employer stock investment restriction) should be denied.

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

Id. at 411-12. *See generally* Michael W. Melton, *Demythologizing ESOPs*, 45 TAX L. REV. 363 (1990) (thorough critical assessment of asserted public welfare benefits of ESOPs).

[31] Traditional doctrine holds that trust terms are fixed unless the settlor expressly reserves the power to revoke or modify the trust. RESTATEMENT (SECOND) OF TRUSTS 331 & cmt. g; IV SCOTT ON TRUSTS, *supra* note 20, § 331; *but see* RESTATEMENT (THIRD) OF TRUSTS 63 & cmt. c (matter of interpretation if power not expressly reserved, supplemented by rebuttable presumptions).Therefore the trustee is motivated to seek administrative deviation in order to obtain insulation from breach of trust claims brought by a dissident beneficiary based on failure to follow the original terms of the trust.

[32] ERISA § 402(b)(3), 29 U.S.C. § 1102(b)(3) (2006). The required procedure can be as simple as a declaration that the plan can be amended by "the Company," leaving to corporate law the specification of who may act for the company and in what manner. Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73 (1995).

This line of analysis suggests that administrative deviation is a distraction. If the corporate employer sponsoring an EIAP is ascribed the role of trust settlor, then in holding out hope of administrative deviation the *Moench* court charted an illusory path to relief. And indeed, case outcomes overwhelmingly reject employee-participants' claims for relief. Continued holding of employer stock is found acceptable even in circumstances that caused it to shed 50%, 70%, or more of its value, and most of the complaints are dismissed at the pleading stage, never even reaching discovery. Notwithstanding the federal courts' nod to administrative deviation, maybe something else is going on in the ERISA stock drop cases.

> If it appears that the settlor did, however, anticipate the circumstances and clearly provided that the trustee should nevertheless have no power to act in such a way as to prevent the failure of the trust, it would seem that the court would not be justified in permitting the trustee so to act, unless the provision is against public policy. Such a provision may be against public policy, however, in extreme cases where to give effect to it would result in the destruction of the trust property.[33]

Perhaps *Moench*'s "presumption of prudence" really functions only as a narrow escape hatch to prevent total destruction of the trust assets in spite of the employer's unambiguous preference for that result. That approach would not effectuate the sponsor's primary purpose; it would override it, but only in truly exigent circumstances. Rephrased in ERISA's terms, such a public policy exception warns that there may come a point where continuing to privilege employee ownership will be taken to demonstrate that the plan fiduciary has stopped acting "for the exclusive purpose of [] providing benefits to participants and their beneficiaries". [34] Such a narrow public policy exception—trust law's version of a ban on burning the Rembrandt—is in substance the position advocated by the plan sponsor in *Fifth Third Bancorp. v. Dudenhoeffer*,[35] the stock drop case pending before the Supreme Court.

Administrative deviation offers a more coherent concept if we put aside the formalistic notion of employer-as-settlor and focus instead on plan participants and taxpayers who bear the economic burden of pension plan funding.[36] As co-settlors in substance, participants initially

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[33] IIA SCOTT ON TRUSTS, *supra* note 20, § 167, at 288.

[34] ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A). Observe that the EIAP diversification exception applies to the prudence requirement "to the extent that it requires diversification" but does not relax the duty of loyalty or the exclusive benefit rule. ERISA § 404(a)(2), 29 U.S.C. § 1104(a)(2). This distinction has an important bearing on the proper interpretation of ERISA's EIAP exception. *See infra* Part IV.B, text accompanying notes .

[35] Brief for Petitioner at 34 Fifth Third Bancorp. v. Dudenhoeffer, No. 12-751:

> An ESOP's purpose of building employees' equity stake in their employer would be defeated if the employer collapses altogether, leaving the employees with *no* meaningful ownership interest. It is therefore only in rare and extraordinary circumstances, and not in run-of-the-mill "stock drop" cases, that the duty of prudence requires ESOP fiduciaries to deviate from the plan terms and abandon the plan's prescribed — and congressionally approved — mission of investing in employer securities.

Observe that employee ownership is the *exclusive* purpose taken into account in petitioner's argument. *Accord id.* at 17.

[36] *See supr*a Part IIA.

subscribed to or acquiesced in the schizophrenic objectives of the plan. Ordinarily, however, ESOP participants are locked into employer stock investments, having no ability to amend the plan (modify trust terms) individually or collectively. If acute risk to their retirement savings materializes, it is sensible to ask a court to authorize a change in investments to carry out the employee-settlors' prioritization of trust purposes.

In addition to ESOPs, this analysis supports liberal access to administrative deviation to quit any EIAP holdings of *non-publicly-traded employer securities*. Consider, for example, a profit-sharing plan that calls for 40 percent of contributions to go into stock of the closely-held employer, with the remainder invested as determined by the plan trustee, named fiduciary, or investment manager.[37] Under such a program participants are locked in to high-risk investments in company stock by both the terms of the plan and the illiquid nature of their ownership position. If a profit-sharing plan includes a cash-or-deferred arrangement (i.e., is a 401(k) plan), ERISA ordinarily demands diversification of assets attributable to workers' elective deferrals.[38] Congress took this step in 1997, recognizing that 401(k) plans had become a major source of pension benefits for many workers, and that "[r]equiring participant contributions to be invested in employer securities or employer real property could have an adverse impact on the retirement security of plan participants."[39] Despite this protection of elective deferrals, employer matching and non-elective contributions can still be required to be invested in company stock that is not publicly traded. Hence, traditional administrative deviation doctrine suggests that settlor-participants who formerly acquiesced in the plan's multiple purposes should be granted a hearing when circumstances change drastically.

The balance of equities is different for a non-ESOP EIAP that holds *publicly-traded employer securities*. Since 2006, participants in a defined contribution plan that holds any publicly-traded employer securities must have the right to move money out of employer stock into diversified investment options.[40] That divestment authority must be immediately exercisable with respect to the employee's elective deferrals, but can be withheld until completion of three years of service as applied to funds attributable to employer contributions. Accordingly, do-it-yourself risk protection is available to any participant who is likely to have accumulated a significant account balance. If plan participants are kept abreast of new developments that threaten the employer's financial health, then it would seem that a claim founded on administrative deviation principles is unwarranted, because the participant-settlors have the

[37] As a general rule, ERISA gives the plan trustee exclusive authority to manage investments unless the plan provides that the trustee is subject to the direction of the named fiduciary or investment authority is delegated to one or more investment managers. ERISA § 403(a), 29 U.S.C. § 1103(a).

[38] ERISA § 407(b)(2), 29 U.S.C. § 1107(b)(2). The elective deferral portion of the fund is deemed to be a separate plan that is not an EIAP. Diversification of funds attributable to salary reduction contributions is not required if not more than one percent of the employee's compensation is required to be invested in employer securities or realty, or if the value of the assets in all defined contribution plans sponsored by the employer is not more than 10% of the total asset value of all single-employer pension plan maintained by the employer. Also exempt from the elective deferral diversification rule are 401(k)-type ESOPs.

[39] STAFF OF THE JOINT COMM. ON TAXATION, 105TH CONG., GENERAL EXPLANATION OF TAX LEGISLATION ENACTED IN 1997, at 445.

[40] ERISA § 204(j), 29 U.S.C. § 1054(j); I.R.C. § 401(a)(35). The right to diversification under ERISA § 204(j) was deliberately crafted to work in tandem with the rules governing participant-directed investments, under § 404(c). *See infra* note 45.

ongoing right to modify the plan (i.e., switch investments) in response to changed circumstances. That conclusion, of course, is founded on the premise that plan participants will receive timely, robust and understandable disclosure of plan finances, but the Supreme Court has not been notably receptive to ERISA misrepresentation claims, except in egregious cases.[41]

Today, most defined contribution pension plans are 401(k) plans, under which workers can elect to contribute part of their pay, and to which the employer may also make matching or nonelective contributions.[42] More than 90% of 401(k) plans allow participants to direct the investment of all or a portion of their accounts, with 89% of 401(k) plan active participants (53.7 million workers in 2010) having investment authority over the full balance.[43] Typically, participants are allowed to select their investments from a menu of mutual funds.[44] Company stock can be offered as an investment option under a participant-directed defined contribution plan only if the stock is publicly traded.[45] That condition limits company stock fund offerings to very large corporations,[46] yet the Labor Department reports that $160 billion of employer securities is held in 401(k) plans that give participants the right to direct the investment of all or a portion of their account balances.[47] Hence a large share of company stock investments—roughly 50 percent of the total for defined contribution plans—is attributable to plans under which the settlor-participants possess ongoing investment management authority. Those pension trusts would not be candidates for distributive deviation under the traditional approach.

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[41] *See* CIGNA Corp. v. Amara, 563 U.S. ___, 131 S. Ct. 1866 (2011) (representations in summary plan description not directly enforceable as the terms of the plan itself, but upon adequate showing of detrimental reliance or likely harm equitable relief may be available under ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3)); *but see* Varity Corp. v. Howe, 516 U.S. 489 (1996) (carefully scripted and deliberately misleading presentation by top corporate executives was fiduciary act violating duty of loyalty).

[42] The Labor Department reports that in 2010, 79.3% of all defined contribution plans were 401(k)-type plans (i.e., included a cash-or-deferred arrangement) and these plans account for 82.4% of active participants in defined contributions plans. EBSA, *supra* note 2, Tables A1, D3.

[43] EBSA, *supra* note 2, Table D6(b). The historical growth in the number and workforce coverage of 401(k) plans is presented in PETER J. WIEDENBECK & RUSSELL K. OSGOOD, CASES AND MATERIALS ON EMPLOYEE BENEFITS 70-73 (2d ed. 2013).

[44] Ordinarily, a defined contribution plan calling for participant-directed investments is designed to comply with ERISA § 404(c), 29 U.S.C. § 1104(c). If the plan offers a suitable range of investment options and provides participants adequate information, then plan fiduciaries (including the trustee) are not liable for any loss that results from a participant's exercise of control over the assets in his account. ERISA § 404(c), 29 U.S.C. § 1104(c); 29 C.F.R. § 2550.404c-1. *See generally* WIEDENBECK, *supra* note 9, at 136-46. That insulation from responsibility for investment losses includes losses traceable to the participant's failure to adequately diversity investments.

[45] The regulations under section 404(c) impose special conditions if employer securities are an investment option. Fiduciary immunity is limited to investments in company stock that is publicly traded with sufficient frequency and volume to assure that participant orders to buy or sell can be carried out expeditiously, among other requirements. 29 C.F.R. § 2550.404c-1(d)(2)(ii)(*E*)(*4*). Hence EIAPs that provide for participant-directed investments offer employer securities as an option only if they are publicly traded.

[46] In 2011, only 2.3% of participant-directed 401(k) plans offered company stock as an investment option, but these plans accounted for 38% of participants. Jack VanDerhei et al., *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2011*, EBRI ISSUE BRIEF No. 380, at 22, 26 (Dec. 2012).

[47] EBSA *supra* note 2, at Table D9 at 54. Some ESOPs contain an elective contribution feature and therefore are also classified as 401(k) plans. I.R.C. §§ 401(k)(1), 4975(e)(7). Consequently, some portion of the $160 billion in participant-directed 401(k) plan holdings of employer securities is also counted in the $202 billion in ESOP holdings reported earlier. *See supra* note 2 and accompanying text.

III. Modern Trust Variation

Trust law has continued to evolve over recent decades. Trust variation standards have been among the most dynamic areas of doctrinal development. That development has all been in the direction of liberalization, broadening the circumstances under which the trustee or trust beneficiaries can modify the original terms of the trust. On permissible trust investments, the Restatement (Third) of Trusts provides:

> In investing the funds of a trust, the trustee
> (a) has a duty to conform to any applicable statutory provisions governing investment by trustees; and
> (b) has the powers expressly or impliedly granted by the terms of the trust, and, except as provided in §§ 66 and 76, has a duty to conform to the terms of the trust directing or restricting investments by the trustee.[48]

A comment to this section recognizes that investment directions imposed by the trust terms "are ordinarily binding on the trustee in managing trust assets, thus often displacing the normal duty of prudence."[49] That ordinary obligation, however, is subject to the exception in § 66, which states the modern rule on equitable deviation, both administrative and distributive.

> The court may modify an administrative or distributive provision of a trust, or direct the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust.[50]

Under this approach it's not necessary "that the situation be so serious as to constitute and 'emergency' or to jeopardize the accomplishment of trust purposes."[51] Moreover, deviation "does not require changed circumstances. It is sufficient that the settlor was unaware of the circumstances in establishing the terms of the trust."[52] This, of course, displaces the far more restrictive "defeat or substantially impair" standard for administrative deviation under § 167 of the Second Restatement, the rule invoked by *Moench*. The Uniform Trust Code adopts a similar approach, noting in commentary that: "While it is necessary that there be circumstances not anticipated by the settlor before a court may grant relief . . . the circumstances may have been in existence when the trust was created."[53]

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[48] Restatement (Third) of Trusts § 91 (2007). *Accord id.* § 76(1) ("duty to administer the trust diligently and in good faith, in accordance with the terms of the trust and applicable law"). A comment elaborates that the "normal duty of a trustee to obey the terms of the trust also does not apply to provisions that are invalid because they are unlawful or against public policy." *Id.* cmt b(1).

[49] *Id.* § 91 cmt. e.

[50] Restatement (Third) of Trusts § 66(1) (2003). Additional guidance on distributive deviation is provided in § 65(2), which conditions judicial approval of a modification inconsistent with a material purpose of the trust on a finding that the reasons for the modification outweigh the material purpose. This is a modern liberalized version of the "*Claflin* doctrine," analyzed in Peter J. Wiedenbeck, *Missouri's Repeal of the* Claflin *Doctrine: New View of the Policy Against Perpetuities?*, 50 MO. L. REV. 805(1985).

[51] Restatement (Third) of Trusts § 66, cmt. a (2003).

[52] *Id.*

[53] Unif. Trust Code § 412 cmt. (2000).

These authorities suggest that where the implications of competing purposes—such as retirement security and employee ownership—are not adequately appreciated when employee-settlors contribute (indirectly) to an EIAP, then the subsequent appearance of serious financial threat to the value of company stock investments can constitute "circumstances not anticipated by the settlor". And once such unforeseen jeopardy comes in view, under the modern approach it is clear that a court could authorize variance from investment directives without finding that the financial health of the company has deteriorated to the point of pending financial collapse. Yet that seems to be just the sort of dire circumstances (emergency situation) that the ERISA cases insist upon as a predicate to lifting a plan mandate to invest in employer stock.[54]

In addition to expanding administrative deviation, modern trust law makes massive incursions on distributive deviation. The traditional American approach to distributive deviation—also known as the *Claflin* doctrine—is that the distributive terms of a trust cannot be modified or terminated, even if all beneficiaries consent, where the change would undercut some material purpose of the settlor.[55] (Distributive terms refer to the central definition of the gift. Basically, that means the identity of trust beneficiaries, the amounts that they take, and when they will get it. The traditional doctrine on distributive deviation was far more uncompromising than the rules on administrative deviation; courts were willing to show more flexibility when the requested change implicated only managerial details of the trust.[56]) Clearly, the employer stock limitation affects how much financial benefit pension trust beneficiaries will obtain, so it might be characterized as a distributive term. In their capacity as settlors, it's fair to charge EIAP participants with a material purpose of employee ownership. But the participants are also the primary beneficiaries of the pension trust. In that capacity, they are seeking relief from self-imposed investment restraints, but at a later time and under changed and circumstances. Under contemporary standards, material purposes that would obstruct change are not lightly to be inferred, and even where apparent an equity court may authorize change if it determines that the reason for modification outweighs the material purpose.[57] Under that modern approach to distributive deviation, perhaps an under-appreciated and not fully thought-through objective of

[54] *Edgar*, 503 F.3d at 349 n. 13 ("We do not interpret *Moench* as requiring a company to be on the verge of bankruptcy before a fiduciary is required to divest a plan of employer securities."); Lalonde v. Textron, Inc., 369 F.3d 1, 6 (1st Cir. 2004) (because the "important and complex area of law implicated by plaintiffs' claims is neither mature nor uniform . . . we believe that we would run a very high risk of error were we to lay down a hard-and-fast rule"); Brieger v. Tellabs, Inc., 2009 U.S. Dist. LEXIS 49747, at *37 (N.D. Ill. June 1, 2009) (leaving open whether the standard is "impending collapse or something short of that"); In re Ford Motor Co. ERISA Litigation, 590 F. Supp. 2d 883, 892-93 (E.D. Mich. 2008) (rejecting the "imminent collapse standard in favor of a rule requiring divestiture "at the point at which company stock becomes so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would invest any plan assets in it, regardless of what other stocks were also held in the plan's portfolio").

[55] *See generally* RESTATEMENT (SECOND) OF TRUSTS § 337; IV SCOTT ON TRUSTS § 337; Wiedenbeck, *supra* note 50.

[56] *Compare* RESTATEMENT (SECOND) OF TRUSTS § 337 with *id.* § 167. The rationale for imposing more restrictive conditions on distributive deviation lies in American property law's fundamental commitment to testamentary and dispositive freedom. In the private trust context, a petition for distributive deviation amounts to a complaint by the donees about their gift—asking the court to rewrite the donor's estate plan. IV SCOTT ON TRUSTS § 337 ("in the United States the wishes of the settlor in creating the trust are paramount to the wishes of the beneficiaries"). *See also* Wiedenbeck supra note 50, at 824-33 (distributive deviation of private trusts compared to *cy pres* revision of charitable trusts).

[57] RESTATEMENT (THIRD) OF TRUSTS § 65; Unif. Trust Code § 411 cmt.

employees' former selves (employee ownership) should readily yield when new conditions trigger a reevaluation of priorities.

The unanimous consent requirement frequently prevented distributive deviation even if the material purpose doctrine did not, because any disabled, minor, unborn, or unascertained beneficiary could not give a legally binding consent. A pension trust may have hundreds or thousands of trust beneficiaries, many of them contingent (an employee's designated beneficiary is subject to change), some of whom cannot be located (common for terminated vested employees), and others are simply disengaged and unresponsive. As such, modification by consent of all beneficiaries under the traditional approach would seem to be out of the question. Contemporary trust law may be significantly less restrictive along this dimension as well, by offering a variety of mechanisms for securing the necessary approval, including virtual representation and court appointment of representatives for absent beneficiaries.[58]

The lesson here is that prevailing state law standards governing trust variation do not impose the extremely restrictive (well-nigh insuperable) barriers that the federal courts following *Moench* mistakenly assume. The interpretation of ERISA, the Supreme Court has frequently admonished, should be guided in the first instance by reference to its trust law origins.[59] Yet trust law is not static, so the question becomes: Trust law, when? The Third Circuit's resort to the Second Restatement's rule on administrative deviation fairly captures doctrinal development as of 1974, but does ERISA's date of enactment freeze (ossify?) background interpretive principles? As applied to employee benefit plans, was trust law fixed in a perpetual state of arrested development in 1974? Some cases seem to assume so,[60] and the plan sponsor so argues in the stock drop case pending before the Supreme Court.[61]

That can't be right. Trust variation principles, after all, function for the most part as rules of interpretation, setting forth considerations to be deployed in response to a petition to adapt the long-term multiparty trust relationship to altered circumstances. Even legislative updates to state trust variation standards are generally applied to preexisting irrevocable trusts—trusts created before enactment are not grandfathered.[62] Presumably, that's because the "purposes of the trust"

[58] Unif. Trust Code § 411 cmt and §§ 305-305; *see also* Wiedenbeck, *supra* note 50, at 812-15 (Mo. Rev. Stat. § 456.590.2 authorizes judicial consent on behalf of disabled, minor, unborn or unascertained beneficiaries).

[59] Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 110 (1989) (ERISA's "fiduciary responsibilities provisions codify and make applicable to ERISA fiduciaries certain principles developed in the evolution of the law of trusts"); Varity Corp. v. Howe, 516 U.S. 489, 496-97 (1996). In Conkright v. Frommert, 559 U.S. ___, 130 S. Ct. 1640 (2010), which concerned the scope of review of an ERISA fiduciary's plan interpretation, Chief Justice Roberts' opinion for the Court engages in an extended disputation with Justice Breyer's dissent over the proper reading of treatises a handful of cases involving a narrow point of private trust law.

[60] *E.g.*, In re McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812, 831 n.16 (N.D. Cal. 2005) (observing that the *Moench* unanticipated circumstances rule was derived from the Restatement (Second) of Trusts § 167, which "reflected the state of the law in 1974 when Congress 'codif[ied] and ma[de] applicable to [ERISA] fiduciaries certain principles developed in the evolution of the law of trusts."' (quoting Firestone, 489 U.S. at 110, and H.R. Rep. No. 93-533, at 11)).

[61] After noting that the deviation standard in the Third Restatement is expressed in "arguably broader language," the employer observes: "To the extent trust law has changed, courts should be guided by the common law as it stood when Congress enacted ERISA." Brief for Petitioner, at 32 n. 12, Fifth Third Bancorp. v. Dudenhoeffer, No. 12-751.

[62] *E.g.*, Unif. Trust Code § 1106 (2000); *but see id.* §411(a).

continue to guide decision making. The tension in ERISA wasn't even perceived in 1974, and Congress had no inkling that when conflict manifested itself federal courts would resort to state trust variation principles to handle it. Far from being in some way implicitly invoked—and so baked into federal pension regulation as the doctrine existed in 1974—the federal common law rule adopted in the *Moench* line of cases was unknowable. In short, any suggestion of congressional incorporation of a fine point of state trust law is utterly fictional. As rules of interpretation, recent relaxation of the conditions on trust variation arguably reflects a shift in emphasis that accords somewhat greater weight to trust beneficiaries' current needs and less insistence on rigid adherence to the settlor's historic priorities.[63] Yet employee-participants are in substance both the settlors and the primary beneficiaries of the pension trust (the plan sponsor serving only as draftsman and trustee),[64] and once employer stock investments become dicey workers (at least those with substantial account balances) relate to the trust predominately as beneficiaries.

IV. Trust Variation and ERISA's Evolution

At a doctrinal level, federal courts' handling of trust variation law in the ERISA stock drop cases has been simplistic, naïve, and anachronistic, as the preceding discussion demonstrates. The central insight of the *Moench* line of cases is nevertheless valid: judicial intervention may be necessary where changed circumstances render incompatible the schizophrenic purposes of an EIAP. At a policy level, does resort to trust variation law afford the appropriate mechanism to resolve this conflict? Unfortunately, trust variation law is at best a poor proxy for accommodating Congress' deeply conflicted objectives.

Trust variation law seeks to salvage a bad situation by reference to the settlor's likely objectives, express or implied. The conflicting objectives embedded in an ESOP or EIAP are not a simple expression of the employer's desires to which the workforce assents; rather, they are enabled, incentivized and shaped by the qualified plan tax subsidy. At core, the ERISA issue does not really concern the purposes and priorities of the settlor(s), however defined.

> Instead of trying to discern and carry out the intentions of the settlor when powers and purposes conflict, in the stock drop cases the courts are trying to discern and carry out the purposes of Congress when employee ownership and retirement security objectives become irreconcilable. The question is one of statutory interpretation, not plan interpretation.[65]

The policy question, in other words, is about accommodating Congress' conflicting purposes and priorities. Filling this lacuna is a job for the federal courts under ERISA, to be accomplished by development of federal common law rules that advance the objectives of employee benefit plan regulation.

What are those regulatory objectives and how should they be prioritized in the case of pension plan investments in company stock? Answering that question requires recourse to

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[63] *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 545 (7th ed. 2007); Wiedenbeck, *supra* note 50, at 830-33.

[64] *See supra* Part II.A.

[65] WIEDENBECK, *supra* note 9, at 151.

ERISA's history, and not simply a static view of the compromises and political alignments of 1974. Just as trust law has evolved significantly since 1974, so too have ERISA and the qualified retirement plan rules. They are among the most frequently and extensively amended federal statutes and post-1974 developments have an important bearing on the proper balance of considerations that should be reflected in a federal common law standard for pension trust variation.

A. Congressional Prioritization

Defendants in ERISA stock drop litigation espouse the view that ESOPs (and by extension other EIAPs) are not a special variety of retirement savings program, they are another creature altogether. Their primary purpose, the argument goes, is to facilitate employee ownership, and in cases of conflict that objective must be preferred over retirement security. A provision of the Tax Reform Act of 1976 is offered in support of unambiguous congressional prioritization of "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."[66] Although "employee retirement income security" was the name and central goal of ERISA, the ESOP-promotion language of the Tax Reform Act of 1976 leads some partisans to ignore retirement security entirely, treating it as irrelevant in the context of an ESOP or other EIAP.[67] But it's a mistake to be dismissive of ERISA's central objective. This part of the article will show that, taking the long view of congressional savings policy—abjuring a tunnel vision focus on 1976—retirement security emerges as the dominant objective. Indeed, the ESOP-promotion language of the Tax Reform Act of 1976, understood in context, amounts to little more than one powerful senator's unilateral concoction of post-enactment legislative history to support his pet project.

Forty years removed from ERISA's enactment, most experts today have lost sight of the fact that some qualified (i.e., tax-favored) profit-sharing and stock bonus plans are not "pension plans" within the meaning of ERISA and therefore are not subject to any of ERISA's fiduciary responsibility provisions.[68] Profit-sharing and stock bonus plans structured as short-term deferred compensation programs designed to provide a worker productivity incentive can qualify for favorable tax treatment.[69] In contrast, to trigger pension plan classification and fiduciary oversight under ERISA a plan must provide retirement income or result in deferral of income to the termination of covered employment or beyond.[70] Where payments under a bonus program

[66] Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1520, 1590.

[67] The company's brief in Fifth Third Bancorp v. Dudenhoeffer, 692 F.3d 410 (6th Cir. 2012), *cert. granted*, 82 U.S.L.W. 3362 (U.S. Dec. 13, 2013) (No. 12-751), routinely refers to "Congress's purpose" (singular), the "purpose [singular] of the ESOP", "An ESOP's purpose [singular] of building employees' equity stake in their employer", or "the plan's purpose [singular] of furthering employee ownership." Brief for Petitioner at 18, 20, 34, 46.

[68] To qualify for favorable tax treatment such plans must be "for the exclusive benefit of [] employees or their beneficiaries". I.R.C. § 401(a) (introductory clause), (a)(2). Although the tax code imposes an exclusive benefit rule (duty of loyalty), it contains no counterpart to ERISA's duties of prudence and diversification.

[69] Treas. Reg. § 1.401-1(b)((1)(ii), (iii) (distributions from profit-sharing or stock bonus plan permitted "after a fixed number of years" even if participant is still actively employed). A "fixed number of years" was later interpreted as two or more. See Rev. Rul. 68-24, 1968-1 C.B. 150.

[70] ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A).

are "systematically deferred to the termination of covered employment or beyond, or so as to provide retirement income to employees" ERISA applies.[71] Consequently, a profit-sharing or stock bonus plan that requires distribution after a short period of deferral—two years or more, but while participants are still employed by the sponsoring company—can be tax qualified but exempt from ERISA Title I.[72] When ERISA was enacted such short-term deferred profit-sharing and stock bonus program were not uncommon. The lesson here is that some tax-subsidized profit-sharing and stock bonus plans, those structured to provide short-term savings as a worker productivity incentive, were not regulated by ERISA at all.[73] In contrast, profit-sharing or stock bonus plans that offer long-term saving and investment (encouraging or requiring deferral to the termination of employment) were, like traditional defined benefit plans, subjected to ERISA's pension safeguards generally, but in deference to their common use as a productivity inducement were permitted to continue making concentrated investments in employer stock.[74]

Understanding that some formerly common fringe benefit programs aimed at giving workers a tax-subsidized stake in their employer corporation are entirely exempt from ERISA[75] makes Congress' decision to allow undiversified employer stock investments under long-term profit-sharing and stock bonus plans less startling. Yet ERISA's central objective, providing "employee retirement income security," still poses a puzzle: Why didn't Congress simply grandfather those undiversified long-term profit-sharing and stock bonus plans that were operating in 1974? Why was the EIAP diversification exception opened to new plans? Two factors seem to explain the ongoing exemption. First, Senator Russell Long, chairman of the Senate Finance Committee, who had recently been converted to the gospel of employee stock ownership (every worker a capitalist),[76] envisioned the tax-subsidized proliferation of ESOPs,

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[71] 29 C.F.R. § 2510.3-2(c).

[72] If instead of mandatory in-service distributions the employee is given the option to continue deferral until separation from service—as profit-sharing and stock bonus plans now overwhelming do—the tax incentive for continued "systematic defer[al]" causes pension classification under ERISA.

[73] This distinction was more clearly articulated in some of the early pension reform proposals, which were drafted to regulate defined benefit plans and "profit sharing retirement plans," but had no application to other profit-sharing plans. *E.g.*, S. 1103, 90th Cong., § 2(4), (13), (25), *reprinted in* 113 CONG. REC. 4653 (1967) (Sen. Jacob Javits' original comprehensive reform bill); S. 3598, 92nd Cong., §§ 3(14), (15), 1004(a), *reprinted in* 118 CONG. REC. 16908 (1972) (bipartisan reform bill); President's Comm. on Corp. Pension Funds, Public Policy and Private Pension Programs 68 (1965) (original cabinet committee recommendations distinguishes "deferred profit-sharing plans designed primarily to provide retirement benefits").

[74] Very early in the development of pension reform legislation there was apparent consensus that profit-sharing and stock bonus plans that explicitly provided for investment in employer securities would be exempt from the prohibition on investing more than 10% of plan assets in employer stock. Proposed "Employee Benefits Protection Act," 91st Cong., § 14(c)(4)(A), *reprinted in* 116 CONG. REC. 7570, 7576 (1970); S. 3598, 92nd Cong., § 509, *reprinted in* 118 CONG. REC. 16908, 16917 (1972) (proposed § 15(c)(4)(A) of the Welfare and Pension Plans Disclosure Act); S. 4, 93d Cong. § 510 (1973) (same).

[75] Still common today are some tax-subsidized programs that encourage employees to hold stock in their employer, which are neither qualified retirement plans nor subject to ERISA. *See* ERISA Opinion 81-18A, 1981 WL 17739 (Feb. 2, 1981) (stock bonus program designed to qualify for favorable tax treatment as an employee stock purchase plan under I.R.C. §§ 421 and 423, is not a "pension plan" subject to ERISA regulation absent unusual circumstances).

[76] Norman G. Kurland, *Dinner at the Madison: Louis Kelso meets Russell Long*, at http://dept.kent.edu/oeoc/publicationsresearch/Winter1997-8/DinnerWin1997-8.html. Russell Long's father, Huey Long, was famous for his wealth redistribution proposal, "Every Man A King," the subject of a nationwide

but appreciated that achieving that end required exemption from ERISA's diversification and prohibited transaction rules. Second, in 1974 profit-sharing and stock bonus plans were not core retirement savings vehicles, but were most commonly employed as supplemental tax-favored savings programs offered in addition to a traditional pension plan that promised a secure basic standard of living in retirement. Hence one extraordinarily powerful senator needed an open-ended diversification exemption to forward his new worker-capitalism crusade,[77] while most observers believed that little harm could come of it, because the profit-sharing and stock bonus plans of that era did not substitute for pension plans (which ERISA would require to be better funded and diversified).[78] Confirmation that the supplemental status of profit-sharing and stock bonus plans was an important premise of the diversification exception can be found in a special rule that withdraws the diversification exception from a defined contribution plan that would otherwise be classified as an EIAP if the plan's benefits are taken into account in determining the benefits and funding of a traditional defined benefit plan.[79] In such a floor/offset arrangement the defined contribution plan's benefits may substitute for benefits that would otherwise be payable under the traditional pension plan, rather than supplementing them (i.e., employer stock

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radio broadcast in 1934, and the title of his autobiography. Huey Long, "Every Man a King" (Feb. 23, 1934), Classic Senate Speeches, at http://www.senate.gov/artandhistory/history/common/generic/Speeches_Long_EveryManKing.htm; HUEY P. LONG, EVERY MAN A KING (1933) (republished in 1964 and 1996).

[77] JAMES A. WOOTEN, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY 257 (2004). See Memorandum from Russell B. Long, Chairman, Senate Finance Committee, to Conference Committee on Pension Reform Legislation (undated, but summer 1974), re "Reference Communication regarding Administration Recommendation favoring prohibited transaction provisions of H.R. 4200 over fiduciary standards of H.R. 2," Russell B. Long Collection, LSU Libraries Special Collections (objecting that request of Secretaries of Treasury and Labor for a change in prohibited transaction rules "would, in the case of stock bonus trusts and money purchase pension trusts designed to be invested wholly or primarily in the sock of the employer corporation, simply prohibit such investment" and repeating his arguments in favor of ESOPs).

[78] The Labor Department estimated that in 1975 39% of private wage and salary workers participated in a primary defined benefit (traditional) pension plan, while only 6% were covered by a primary defined contribution plan (most of which were presumably money purchase pension plans, which must be regularly funded diversified), but in addition 9% of workers were covered by a supplemental defined contribution plan. PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR, PRIVATE PENSION PLAN BULLETIN: ABSTRACT OF 1995 FORM 5500 ANNUAL REPORTS, Table E4 (1999). Almost all supplemental or secondary plan coverage (in 1974 and to this day) is provided by defined contribution plans. Virginia P. Reno, *The Role of Pensions in Retirement Income: Trends and Questions*, 56 SOC. SEC. BULL. 29 (1993).

[79] ERISA § 407(d)(3)(C), 29 U.S.C. § 1107(d)(3)(C). Although this special rule was added in 1987, the House Education and Labor Committee asserted that the result was consistent with prior law and the amendment merely disabused some sponsors of a mistaken impression:

> The Committee is concerned that, as a result of this mistaken impression, a few employers have adopted floor/offset arrangements that violate section 407 of ERISA, since the individual account portion is invested primarily or exclusively in employer securities. If the employer experiences sudden financial difficulties and the price of its stock plummets, the defied benefit plan may experience a sudden and deep funding deficiency, at exactly the time that the employer is least able to fund such a deficiency. This results in an unreasonable risk to the benefit security of plan participants and to the PBGC. It was for this reason that Congress imposed the 10% limit on the amount of employer securities that a defined benefit plan can hold in ERISA.

H.R. Rep. No. 100-391, part I, at 117 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2323-1, 2313-91.

accumulations would subtract from rather than adding to support provided by a reliable life annuity).

The crucial unstated premise of the diversification exception—that ESOPs and other EIAPs would supplement, rather than substitute for, traditional pensions—was not imposed as a condition on the diversification exception. Things change. The qualified retirement plan universe has evolved rapidly and in unexpected directions since 1974. Legislative authorization in 1978 of elective pre-tax salary reduction contributions under a cash-or-deferred arrangement (CODA) component of a qualified profit-sharing or stock bonus plan[80] was followed during the 1980s by dramatic increases in the number and workforce coverage of profit-sharing and stock bonus plans with CODA features (now known generically as 401(k) plans).[81] In the late 1980s and 1990s the defined benefit plan funding and termination insurance regime was made far more burdensome for plan sponsors, leading many companies to close their traditional pension plans to new entrants, freeze their plans by ceasing additional accruals for all participants, terminate their plans, or convert them to a cash balance structure that mimics the characteristics of a money purchase pension plan.[82] The combined effect of these two developments over the last 25 years

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[80] I.R.C. § 401(k). The tax status of elective contributions made under a CODA became a controversial issue during ERISA's gestation. In 1972 the Treasury proposed regulations that would treat salary reduction contributions as after-tax employee contributions rather than excludible (pre-tax) employer contributions. Opponents sought relief, and succeeded in getting a temporary moratorium on new regulations included in the statute. The moratorium preserved the prior law treatment of salary reduction contributions under plans in existence on June 27, 1974, to allow time for congressional study of the matter. ERISA § 2006, Pub. L. No. 93-406, 88 Stat. 829, 992 (1974); H.R. Rep. No. 93-1280, at 355-56 (Conf. Rep. 1974); H.R. Rep. No. 93-807, at 142-45 (1974).

When ERISA was enacted, plans to which employees made elective contributions were commonly known as thrift or savings plans. This explains the now obscure reference in the definition of an EIAP to a "thrift, or savings plan" in addition to profit-sharing plans, stock bonus plans, and ESOPs. ERISA § 407(d)(3)(A), 29 U.S.C. § 1107(d)(3)(A). Usually employers encouraged voluntary saving by offering some level of matching contributions under such plans. If only employees contributed and distributions were made in cash, the IRS ruled that such programs did not satisfy the definition of a pension, profit-sharing, or stock bonus plan in Treas. Reg. § 1.401-1(b). Rev. Rul. 68-651, 1968-2 C.B. 167 (where employer does not contribute employees do not participate in profits; instead of profit-sharing plan arrangement is "a mere savings plan"). Hence, voluntary savings plans funded only by employees could be pension plans subject to ERISA, ERISA § 3(2)(A), 29 U.S.C. § 1002(2)(A) (established or maintained by employer, regardless of method of contributions), without being classified as a profit-sharing or stock bonus plan. If distributions were made in employer stock, however, it appear that such an arrangement would be categorized as a stock bonus plan even if funded solely by employee contributions.

[81] The number of active participants in 401(k) plans grew from 7.5 million workers in 1984, to 19.5 million in 1990, 39.8 million in 2000, and 60.5 million in 2010. EBSA, PRIVATE PENSION PLAN BULLETIN HISTORICAL TABLES AND GRAPHS Table E20 (June 2013), at http://www.dol.gov/ebsa/pdf/historicaltables.pdf. Graphs showing the phenomenal change in the private pension plan universe since 1975 appear in WIEDENBECK & OSGOOD, *supra* note 43, at 72-73.

[82] As late as 1993 there were still 25.1 million active participants in private defined benefit plans of all types and 23.1 million active participants in 401(k) plans. PENSION AND WELFARE BENEFITS ADMINISTRATION, PRIVATE PENSION PLAN BULLETIN: ABSTRACT OF 1993 FORM 5500 ANNUAL REPORTS, Tables A1, D3 E4 (1996), at http://www.dol.gov/ebsa/publications/bulletin/intro.htm. As of 2011, there were 16.5 million active participants in private defined benefit plans of all types (but 5.3 million of these were in cash balance plans) and 61.4 million active participants in 401(k) plans. there were about 25 million active participants in private defined benefit plans of all types and 22 million active participants in 401(k) plans. EBSA, PRIVATE PENSION PLAN BULLETIN: ABSTRACT OF 2011 FORM 5500 ANNUAL REPORTS, Tables A1, D3 E4 (2013), at http://www.dol.gov/ebsa/pdf/2011pensionplanbulletin.pdf.

has led to the virtual collapse of traditional pensions and the dominance of 401(k) plans.[83] Today, 401(k) plans are commonly the only qualified retirement plan available to most workers, and as profit-sharing or stock bonus plans they can take advantage of ERISA's diversification exception.

Just as the first mild tremors of the coming tectonic shift from traditional defined benefit plans to 401(k) profit-sharing plans were registered, Russell Long's ESOP campaign was on the march. Beyond the protection provided by ERISA's diversification and prohibited transaction exceptions, under Senator Long's Finance Committee leadership additional ESOP tax incentives were added in the years following ERISA's passage. These included a tax credit for company contributions of stock to an ESOP (in 1975), deferral of gains realized by shareholders on the sale of stock to an ESOP, a corporate deduction for dividends paid on ESOP shares, and a 50 percent exclusion of interest earned by banks and other lenders on loans to ESOPs, and favorable estate tax treatment for stock sales to an ESOP.[84] In 1976 Congress expanded the tax credit for stock contribution to ESOPs, and accompanied that increased subsidy with a statutory declaration:

> [to make 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 trusts and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.[85]

This is a strong endorsement of ESOP growth. Nevertheless, it implicitly acknowledges that ESOPs are retirement plans, albeit of an unconventional sort. Moreover, the conference report explains that this language is a reaction to proposed Treasury and Labor Department regulations on prohibited transactions, and sets out a three-page list of "areas of specific concern to the conferees" that might be too restrictive for ESOPs, especially leveraged ESOPs, to function effectively.[86] This shot across the bow of the bureaucracy makes no reference to the EIAP diversification exception or the scope of the prudence requirement. More importantly, it was enacted as a substitute for a provision in the original Senate bill that would have exempted ESOPs from all of ERISA Title I—including all fiduciary responsibility rules—by simply declaring that ESOPs are not "employee benefit plans" and are thus not subject to ERISA at

[83] *See generally* Edward A. Zelinsky, The Origins of the Ownership Society (2007); Matthew P. Fink, The Rise of Mutual Funds 72, 128-29 (2008).

[84] Andrew W. Stumpff, *Fifty Years of Utopia: A Half-Century After Louis Kelso's* The Capitalist Manifesto*, a Look Back at the Weird History of the ESOP*, 62 Tax Law. 419, 425-26 (2009).

[85] Tax Reform Act of 1976, § 803(h), Pub. L. No. 95-455, 90 Stat. 1520, 1590. The 1976 Act also amended ERISA to mandate a congressional staff study to review and report on "the broadening of stock ownership, particularly with respect to employee stock ownership plans * * * and all other alternative methods for broadening stock ownership of the American labor force and others". *Id.* § 803(i), adding ERISA § 3022(a)(4), 29 U.S.C. § 1222(a)(4).

[86] H.R. Rep. No. 94-1415, at 539-42 (1976). The alarming proposed prohibited transaction rules appear at 41 Fed. Reg. 31833, 31870 (July 31, 1976).

all![87] ESOPs, in other words, would thereafter have been regulated exclusively under the tax laws. (The Code being Chairman Long's fiefdom—it appears that the peasants revolted.)

In the decade after 1976 Senator Long continued to promote ESOPs, serving as legislative protector and commissioning several GAO studies.[88] But the tax credit for ESOP contributions was eventually repealed, and some of the other lucrative ESOP tax incentives were trimmed or eliminated.[89] The diversification exception, a necessary condition for ESOPs, of course survived, but its meaning may have undergone a subtle shift in 1986. By imposing a 10 percent additional tax on early distributions from qualified plans[90]—including profit-sharing and stock bonus plans, which previously could allow participants to make in-service withdrawals without penalty—Congress effectively declared that henceforth EIAPs were to function primarily as retirement savings programs.[91]

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[87] The Senate version of H.R.10612, 94th Cong. §804(g)(1), as reported July 10, 1976, with amendments, provided:

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

S. Rep. 94-938, Part II, at 6 (1976) reports that the Finance Committee deleted a provision previously agreed to (above) that "would end the treatment of ESOP's as employee pension or welfare plans under Federal law (other than tax law)." *Id.* at 74 (same).

[88] GAO, Initial Results of a Survey on Employee Stock Ownership Plans and Information on Related Economic Trends (Sep. 30, 1985); GAO, Employee Stock Ownership Plans: Interim Report on a Survey and Related Economic Trends (Feb. 1986); GAO, Employee Stock Ownership Plans: Benefits and Costs of ESOP Tax Incentives for Broadening Stock Ownership (Dec. 1986); GAO, Employee Stock Ownership Plans: Little Evidence of Effects on Corporate Performance (Oct. 1987). The final report of this series, the first to express skepticism concerning the efficacy of ESOPs in motivating workers (productivity incentive) or improving corporate performance, was issued after Russell Long retired from the Senate.

[89] Stumpff, *supra* note 84, at 429-30.

[90] I.R.C. § 72(t).

[91] President Reagan's 1985 tax reform recommendations ("Treasury II") observed:

> The current [distribution] rules also undercut the basic rationale for tax-favored plans, which is the encouragement of retirement savings . . . .
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> * * *
>
> The current favorable tax treatment of certain plan distributions undercuts retirement saving by encouraging early and lump sum withdrawals. The ability of individuals to gain access to the tax advantages provided to tax-favored funds before retirement permits employees to use tax-favored plans as short-term savings accounts rather than as retirement savings vehicles.

THE PRESIDENT'S PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY 344, 345 (May 1985). Interestingly, the Senate's tax reform bill generally exempted ESOP distributions from the additional tax, H.R. 3838, 99th Cong. § 1223(a) (as reported with an amendment May 21, 1986) (adding I.R.C. § 72(t)(2)(C)); S. Rep. 99-313, at 613 ("The committee recognizes that the purpose of ESOPs is to create for employees an ownership interest in employer securities and believes that this special purpose warrants distinguishing ESOPs from plans the primary purpose of which is to provide retirement savings.") The conference committee rejected that view, generally applying the additional early withdrawal tax to ESOP distributions made on or after January 1, 1990, leaving only a limited exception for dividends paid on employer stock owned by the ESOP that are distributed to plan participants or their beneficiaries. H.R. Rep. No. 99-841, at II-456 (1986); I.R.C. §§ 72(t)(2)(A)(vi), 404(k).

We still tolerate the risks inherent in ESOPs and other EIAPs to encourage employee ownership. When ENRON collapsed and most employees' retirement savings—invested in ENRON stock—vanished, Congress did not repeal the diversification exception. Instead it belatedly required that defined contribution plans holding publicly-traded employer securities give participants a right to divest employer stock held in their accounts.[92] But taking a long view of the evolution of profit-sharing and stock bonus plans, and considering their interrelated treatment under both federal tax and labor law, three firm conclusions emerge. First, although the tax law originally conceived profit-sharing and stock bonus plans as simply deferred bonus payments in cash or stock (respectively) to encourage worker productivity, ERISA takes cognizance of only that subset of qualified profit-sharing and stock bonus plans that facilitate long-term deferral of the bonus.[93] To be within ERISA's scope is to be directed, at least in part, to the provision of retirement support. Second, the ESOP-promotion declaration in the Tax Reform Act of 1976 did not endorse an exclusive goal of employee ownership in all circumstances. Its narrow purpose was to warn the Administration to reconsider proposed prohibited transaction regulations; more broadly, it seems to have been a face-saving measure, adopted in the wake of the Finance Committee's refusal to go along with an across-the-board exemption of ESOPs from ERISA's labor law requirements, including all fiduciary obligations.[94] Third, the general application of the early distribution penalty to all tax-subsidized savings arrangements in 1986 arguably marks a turning point in congressional prioritization of qualified plan purposes: retirement income security became the prime directive.[95]

B. Coordination in Crisis

How does this convoluted and obscure history bear upon the proper resolution of ERISA stock drop litigation? Does the *Moench* presumption of prudence fairly accommodate competing legislative objectives? And if not, where can federal courts turn for guidance?

The *Moench* presumption, as currently applied, accords dominant weight to employee ownership, treating it as the plan's controlling objective until the employer is on the brink of collapse. By ignoring retirement security—at most giving it lip service—EIAP fiduciaries can argue that the commitment to investment in employer stock must be maintained, regardless of value, so long as the company can stay out of bankruptcy. That's because "An ESOP's purpose of building employees' equity stake in their employer would be defeated if the employer collapses altogether, leaving employees with *no* meaningful ownership interest."[96] Under this single-purpose view of EIAPs, deviation is possible only where continued investment in employer stock is against public policy, "in extreme cases where to give effect to [the investment

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[92] *See supra* note 40 and accompanying text; STAFF OF THE JOINT COMM. ON TAX'N, 109TH CONG., TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," at 217-23 (Aug. 3. 2006). Every tax preference, of course, creates its own constituency that is powerfully motivated to preserve it.

[93] *See supra* text accompanying notes 68-74.

[94] *See supra* text accompanying notes 85-87.

[95] *See supra* text accompanying notes 88-91.

[96] Fifth Third Bancorp. v. Dudenhoeffer, No. 12-751, Brief for Petitioner at 34 (emphasis in original). Especially revealing is usage of the singular, an "ESOP's purpose". To like effect see id. at 24: "if a company is faced with impending collapse, the plan's core goal of employees holding an ownership interest in their employer would be jeopardized; the virtues of employee ownership disappear if the employer itself disappears." *Accord id.* at 51, 52.

instruction] would result in the destruction of the trust property."[97] But as explained earlier, such a narrow public policy exception is essentially equivalent to a determination that the continued investment in employer stock would violate the ERISA's duty of loyalty, the obligation to act for the exclusive purpose of providing benefits to participants and beneficiaries.[98]

If the exclusive benefit rule triggers divergence from the plan's instruction to invest in company stock, then what's become of the duty of prudence? Congress waived the duty of prudence as applied to EIAPs "only to the extent that it requires diversification".[99] Yet if the public policy exception governs the divestment decision, then prudence has no independent role to play. Clearly, Congress contemplated that the acquisition or holding of employer stock holding might be imprudent even absent concentrated investment. The public policy exception (brink of collapse) approach almost reads Congress' express preservation of a general duty or prudence out of the statute. The second parenthetical clause in ERISA § 404(a)(2), "only to the extent that it requires diversification", becomes surplusage in the context of ERISA stock drop claims.[100] So understood, *Moench* did not establish a presumption of prudence, it adopted a rule making prudence irrelevant.

But can prudence have any independent force apart from diversification in the context of stock drop claims? Perhaps. As a matter of statutory interpretation, it's important to recall that ERISA was enacted before modern economic insights—the efficient market hypothesis and modern portfolio theory—had been incorporated into legal doctrine, and trust investment law in particular.[101] By 1974 trust investments in corporate stock were generally acceptable, but the propriety of particular investment was still generally assessed in isolation according to whether an individual security was unduly speculative, without reference to its contribution to the risk and return characteristics of the portfolio as a whole.[102] The American Law Institute's influential *Restatement (Third) of Trusts: Prudent Investor Rule*, a watershed in the legal recognition of modern portfolio theory, was not promulgated until 1990.[103] During the late 1960s and early 1970s, the era of ERISA's development, the prudence of an accurately-priced investment viewed in isolation (i.e., without reference to the portfolio as a whole) was a concept that still had widely accepted legal meaning, even if it would soon be shown to be financially naïve. It seems likely that a prudence requirement, apart from diversification, would then be understood as meaningful, and would be taken to invoke traditional trust investment principles, including the ban on "speculative" investments and investments in new and untried enterprises. Of course, trust investment law as it stood before modern portfolio theory is not sound economics, but it was the prevailing fiduciary investment standard pre-ERISA, and so perhaps it lives on in the limited

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[97] IIA SCOTT ON TRUSTS, *supra* note 20, § 167, at 288.

[98] *See supra* text accompanying notes 33-35.

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

[100] The prudence savings clause might, however, be accorded a limited meaningful interpretation. It could be read as saying only that EIAP fiduciaries, in decisions concerning "acquisition or holding" of employer stock, must use reasonable care to assure that they buy or sell shares at a price that reflects fair market value.

[101] *See generally* John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investing*, 81 IOWA L. REV. 641, 6421-50 (1996).

[102] *See* RESTATEMENT (SECOND) OF TRUSTS, *supra* note 17, § 227 & cmts. e, f & m; III SCOTT ON TRUSTS, *supra* note 20 , §§ 227.5, 227.6, 227.11.

[103] AMERICAN LAW INSTITUTE, RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 227(a) (1990). For historical and theoretical background, see especially the introductory note (pp. 3-7) and § 227 cmts e, f, g, and h.

arena of EIAP investments in employer stock. Nor is it necessarily irrational in the context of an ESOP or employer stock fund facing dramatically changed circumstances, if the meaning of impermissibly "speculative" investments is interpreted in light of a benchmark set by employees' expectations based on experience (corporate performance, stock price volatility, etc.) during their period of participation. As Richard Posner observes:

> [T]he fall in UAL's [the corporate sponsor's] market price was increasing the risk borne by the owners of its stock, the participants in the ESOP. As we know, the higher the ratio of fixed-interest debt to equity is, the riskier is the position of the equity holders (the common stockholders). As the value of UAL, as reckoned by the stock market, plummeted, the company's debt-equity ratio soared because its debt wasn't decreasing, and this increased the risk borne by the ESOP participants beyond what had been expected when the ESOP was created. At some point in the slide, therefore, the duty of prudence may have overridden the presumption that an ESOP trustee is not required to diversity.[104]

The trick is for a court to coherently decide when that point is reached.[105] That's no easy assignment, of course, and there can be no bright-line rules, but it is a task Congress left for the judiciary: developing a federal common law of employee benefit plans.

The historic approach to administrative deviation (reflected in the Second Restatement), on which the *Moench* line of cases is founded, effectively pays no heed to Congress' primary retirement saving objective, conflating the plan fiduciary's duties of care and loyalty (meaning, in ERISA's terminology, the obligations to act prudently and for the exclusive purpose of providing benefits). The modern more liberal approach to trust variation (embodied in the Third Restatement and Uniform Trust Code), applied sensitively by giving real credence to the retirement security objective, might serve as an adequate standard for accommodating *Congress'* conflicting purposes. As a standard, trust variation principles offer only guidelines for judgment, not a clear-cut rule with which federal courts can readily dispose of complex cases. Nevertheless, fealty to congressional objectives (plural and confused) seems to require it.

V. Conclusion

The presumption that an eligible individual account plan (EIAP) is justified in continuing undiversified investments in employer stock, first recognized in *Moench v. Robertson*, is derived from state trust principles governing judicial authority to modify the terms of a private trust when necessary to respond to an unanticipated emergency. These trust variation doctrines apply in factual circumstances that are loosely analogous to the crashing ESOP situation, but a solid conceptual basis for their application to pension trusts under ERISA is lacking. The importation of traditional trust variation principles into ERISA elides several serious difficulties. The automatic assumption that the employer sponsoring an EIAP is the "settlor" of the pension trust is one problem. Even if the plan sponsor may be treated as settlor, *Moench* and its progeny overlook an essential premise of the Second Restatement's administrative deviation rule: it would not apply to a private trust that is amendable in the way that a pension trust is required to

[104] POSNER, *supra* note 63, at 477.
[105] *Id.* (implied skepticism that courts are up to the task).

be. In addition, the federal courts have overlooked the fact that modern trust variation principles are far more liberal than the black letter rule set forth in the Second Restatement, which was adopted in 1957. In short, the overlooked or misunderstood provenance of the *Moench* presumption has caused serious confusion, leading federal courts in ERISA stock drop cases to apply outdated private trust doctrines that have little direct bearing on quasi-public (i.e., tax-subsidized) pension trusts.

Proper resolution of fiduciary breach claims founded on failure to diversify EIAP employer stock holdings begins with recognition that the matter involves statutory interpretation, not plan interpretation. Accommodating Congress' multiple goals (inducing both employee ownership and retirement savings) when they come into conflict requires a critical assessment of legislative priorities, which emerged and evolved over decades, and which are evidenced by complex, technical, and often seemingly unrelated provisions of both the tax code and ERISA. A comprehensive evaluation of priorities indicates that the presumption of prudence as developed to date in the *Moench* line of cases ill serves ERISA's objectives.