No. 12-751

In the Supreme Court of the United States

FIFTH THIRD BANCORP, et al.,
Petitioners,
v.

JOHN DUDENHOEFFER, et al.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITIONERS' BRIEF ON THE MERITS

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QUESTION PRESENTED

Whether the Sixth Circuit erred by holding that plaintiffs were not required to plausibly allege in their complaint that the fiduciaries of an ESOP abused their discretion by remaining invested in employer stock, in order to overcome the presumption that their decision to invest in employer stock was reasonable, as required by the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001, *et seq.* ("ERISA"), and every other circuit to address the issue.

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioners (Defendants/Appellees below) are Fifth Third Bancorp, Kevin T. Kabat, Members of the Fifth Third Bank Pension, Profit Sharing and Medical Plan Committee (who include Paul L. Reynolds, Nancy Phillips, Greg D. Carmichael, Robert Sullivan and Mary Tuuk). Respondents (Plaintiffs/Appellants below) are John Dudenhoeffer and Alireza Partovipanah.

Fifth Third Bancorp is a publicly traded company and has no parent company. No publicly traded corporation owns 10% or more of its stock.

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BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the Sixth Circuit is reported at 692 F.3d 410, and reproduced at Pet. App. 1-27. The order denying the petition for rehearing and rehearing *en banc* is not reported, but reproduced at Pet. App. 55-56. The opinion of the district court is reported at 757 F. Supp. 2d 753, and reproduced at Pet. App. 28-54.

STATEMENT OF JURISDICTION

The court of appeals entered its judgment and opinion on September 5, 2012, and denied rehearing and rehearing en banc on October 12, 2012. The court of appeals had jurisdiction under 28 U.S.C. § 1291. Petitioners timely filed a petition for a writ of certiorari on December 14, 2012, which this Court granted limited to Question 1 on December 13, 2013. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Relevant excerpts of 29 U.S.C. §§ 1104, 1106, 1107, and 1108, as well as section 803 of the Tax Reform Act of 1976, Pub. L. No. 94-455, are reproduced in a Statutory Appendix to this Brief. 29 U.S.C. §§ 1104-08 are also reproduced in full in the Appendix accompanying the Petition for a Writ of Certiorari at Pet. App. 57-114.

STATEMENT OF THE CASE

1. ERISA. The Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001, *et seq*. ("ERISA"), governs employee benefit plans, including pension plans. ERISA recognizes two categories of

pension plans: individual account plans (also known as defined contribution plans) and defined benefit plans. In an individual account plan, a participating employee's benefit is based on the value of the portion of the plan's assets that is allocated to an individual bookkeeping account maintained for that employee. Each participating employee's account is credited with the employee's share of the employee and employer contributions to the plan. The employee's account balance is adjusted upward or downward to reflect the employee's share of the plan's investment gains or losses. *See* 29 U.S.C. § 1002(34).

Participants in individual account plans are not assured a fixed benefit at retirement. Instead, their benefits depend on the plan's investment performance. In contrast, defined benefit plans provide a guaranteed benefit payable at retirement age. Participants in defined benefit plans generally are not exposed to the risk of negative investment experience, but they also have no opportunity to benefit if the plan experiences investment gains. *See* 29 U.S.C. § 1002(34), (35); *LaRue v. DeWolff, Boberg & Assocs.*, 552 U.S. 248, 250 n. 1 (2008); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-41 (1999).

Most private sector retirement plans are individual account plans with cash or deferred arrangements, commonly referred to as "401(k) plans." *See* 26 U.S.C. § 401(k); U.S. Dep't of Labor, Employee Benefits Security Admin., Private Pension Plan Bulletin Historical Tables and Graphs, at 1, 31 (2013). Many of these plans allow each participant to allocate the participant's account balance among several designated investment options. This feature allows each

participant to create an investment portfolio under the plan that has risk and return characteristics that the participant considers appropriate for his or her individual circumstances.

ERISA neither requires employers to maintain pension plans for their employees nor specifies the benefits a plan must provide. Instead, ERISA seeks to encourage employers to maintain benefit plans for their employees on a voluntary basis. Accordingly, Congress sought to strike a balance "between ensuring fair and prompt enforcement of rights under a plan and the encouragement of the creation of such plans." *Conkright v. Frommert*, 559 U.S. 506, 517 (2010) (citation and internal quotation marks omitted). *See also* H.R. Rep. No. 93-807, at 2 (1974) ("[P]rivate retirement plans are voluntary on the part of employers, and, therefore, [the committee] has weighed carefully the additional costs to the employers and minimized these costs to the extent consistent with minimum standards for retirement benefits.").

ERISA protects pension and other benefits by subjecting the management and administration of employee benefit plans to fiduciary standards, including a duty of prudence and a duty of loyalty. The duty of prudence requires plan fiduciaries to discharge their duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B). The duty of loyalty requires a fiduciary to discharge the fiduciary's duties under the

plan solely in the interest of plan participants. 29 U.S.C. § 1104(a)(1)(A).

The general framework of ERISA's fiduciary standards is derived from the common law of trusts. *See Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989). "Congress expect[ed]," however, "that the courts will interpret this prudent man rule (and the other fiduciary standards) bearing in mind the special nature and purpose of employee benefit plans." *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996) (internal quotation marks and citations omitted) (alteration in original).

2. EIAPs and ESOPs. In ERISA and subsequent legislation, Congress encouraged employers to offer employer stock as an investment or investment option in their individual account plans. ERISA exempts employer stock funds from requirements that would otherwise hamper their operation. Specifically, ERISA exempts "eligible individual account plans" ("EIAPs")[1] from the generally applicable requirement that fiduciaries "diversify[ ] the investments of the plan so as to minimize the risk of large losses." 29 U.S.C. § 1104(a)(1)(C); *id.* § 1104(a)(2). ERISA also exempts EIAPs from the generally applicable 10% limit on the portion of plan assets that may be invested in employer securities and employer real property. 29 U.S.C. § 1107(a), (b).

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[1] In general terms, an EIAP is an individual account plan that "explicitly provides for acquisition and holding of qualifying employer securities . . . ." 29 U.S.C. § 1107(d)(3).

An "employee stock ownership plan" ("ESOP") is a type of EIAP that is defined as (i) a tax-qualified stock bonus plan (or a stock bonus plan and a money purchase plan, both of which are tax-qualified), which (ii) "is designed to invest primarily in qualifying employer securities," and (iii) meets any requirements prescribed by the Secretary of the Treasury by regulation. 29 U.S.C. § 1107(d)(3)(A) & (d)(6). The pertinent Treasury regulation provides that an ESOP must be formally designated as such in the plan document; that an ESOP may form part of a plan that is not an ESOP; and that the plan must specifically state that it is designed to invest primarily in qualifying employer securities. *See* 26 C.F.R. § 54.4975-11(a)(1), (2), & (5); *see also* 29 C.F.R. § 2550.407d-6(a)(2) ("To be an ESOP, a plan must be formally designated as such in the plan document."); *id.* § 2550.407d-6(b) ("A plan constitutes an ESOP only if the plan specifically states that it is designed to invest primarily in qualifying employer securities.").

Although ERISA prohibits most transactions between a plan and the sponsoring employer, 29 U.S.C. §§ 1002(14)(C), 1106(a)(1), ERISA provides an exemption for purchases and sales of employer securities, 29 U.S.C. § 1108(e), and permits an ESOP to borrow from the employer in order to invest in employer stock, 29 U.S.C. § 1108(b)(3).

The Internal Revenue Code offers tax incentives for employers to maintain plans that invest in employer stock. *See* 26 U.S.C. § 404(k) (deductible dividends on employer stock held by ESOP); *id.* § 402(e)(4) (preferential tax treatment for distributions of

appreciated employer stock); *id*. § 1042 (deferring tax on gain from sale of employer stock to ESOP).[2]

In the Tax Reform Act of 1976, Congress emphasized its intent in ERISA and other laws to "encourag[e] employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system" and "bringing about stock ownership by all corporate employees." Pub. L. No. 94-455, § 803(h), 90 Stat. 1520, 1590 (codified at 26 U.S.C. § 4975 note). Congress was "deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trust and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans." *Id.*; *see also Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003) ("Congress, believing employees' ownership of their employer's stock a worthy goal, has encouraged the creation of ESOPs both by giving tax breaks and by waiving the duty ordinarily imposed on trustees by modern trust law (including ERISA) to diversify the assets of a pension plan" (internal citations omitted)); *Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983) ("Congress has repeatedly

[2] Congress has at times offered additional incentives, including tax credits for contributions to an ESOP, *e.g.,* Tax Reduction Act of 1975, Pub. L. No. 94-12, § 301; Tax Reform Act of 1976, Pub. L. No. 94-455, § 803; Revenue Act of 1978, Pub. L. No. 95-600, § 141, and an exclusion from a lender's taxable income of 50% of the interest received on a qualifying loan to finance an ESOP's acquisition of employer securities, *see* 26 U.S.C. § 133 (repealed).

expressed its intent to encourage the formation of ESOPs by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that goal.").

Consistent with these principles, a Third Circuit decision that has been followed by other courts of appeals explained that ESOPs, unlike ordinary retirement plans, are not intended to guarantee retirement benefits because their very nature "places employee retirement assets at much greater risk than does the typical diversified ERISA plan." *See Moench v. Robertson*, 62 F.3d 553, 568 (3d Cir. 1995) (quoting *Martin v. Feilen*, 965 F.2d 660, 664 (8th Cir. 1992)). EIAP fiduciaries (including ESOP fiduciaries) are exempt from the duty to diversify investments "so as to minimize the risk of large losses." 29 U.S.C. § 1104(a)(1)(C), (a)(2). The ESOP "serves a purpose expressly approved and encouraged by Congress," and therefore "as a general matter, 'ESOP fiduciaries should not be subjected to breach-of-duty liability for investing plan assets in the manner and for the . . . purposes that Congress intended.'" *Moench*, 62 F.3d at 571 (quoting *Martin*, 965 F.2d at 670).

Moench explained that a non-deferential standard of review of an ESOP fiduciary's decision to invest or remain invested in employer stock would render "meaningless the ERISA provision excepting ESOPs from the duty to diversify." 62 F.3d at 570. Such a standard "would risk transforming ESOPs into ordinary pension benefit plans, which then would frustrate Congress' desire to encourage employee ownership." *Id.* Instead, an ESOP is like a "trust

under which the trustee is directed to invest the assets primarily in the stock of a single company"; in these circumstances, "basic principles of trust law require that the interpretation of the terms of the trust be controlled by the settlor's intent." *Id*. at 570-71.

> [K]eeping in mind the purpose behind ERISA and the nature of ESOPs themselves, . . . an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision.

Id. at 571.

Drawing on trust law, *Moench* explained that, in light of this presumption of prudence, "the most logical result is that the fiduciary's decision to continue investing in employer securities should be reviewed for an abuse of discretion." *Id.* Under this deferential standard, a plaintiff can overcome the presumption of prudence by showing that "owing to circumstances not known to the settlor and not anticipated by him [continued investment in employer stock] would defeat or substantially impair the accomplishment of the purposes of the trust." *Id.* (quoting Restatement (Second) of Trusts § 227 cmt. q, mistakenly cited as cmt. g). "[I]n other words, the plaintiff must show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate;" moreover, if the ESOP fiduciary "does not maintain the investment in the employer's securities, it may face liability" for failing to comply with plan documents, "particularly if the employer's securities thrive." *Id*. at 571-72. The other

courts of appeals that have addressed the issue have uniformly agreed that a presumption of prudence applies in reviewing an ESOP fiduciary's decision to continue investing in employer securities.

3. The Fifth Third Plan. Fifth Third Bancorp ("Fifth Third") is a diversified financial services company headquartered in Cincinnati, Ohio. J.A. 24 (¶ 28); Pet. App. 43. During the relevant period, Fifth Third had $119 billion in assets and operated 16 affiliates with 1,311 full-service Banking Centers. *Id.*

Fifth Third sponsored the Fifth Third Bancorp Master Profit Sharing Plan ("Plan"), an individual account plan with a 401(k) feature. Pet. App. 29.[3] The Plan is designed to "provide retirement and other benefits for Participants and their respective beneficiaries," as well as a vehicle for participants to "invest primarily in qualifying employer securities." J.A. 284-85 (Plan, art. 1.2(a)). That vehicle is the Fifth Third Stock Fund, which "in all events . . . shall be an investment option," J.A. 735 (Trust Agreement, art. 3.3(a)), and which "shall be invested primarily in shares of common stock of Fifth Third Bancorp," J.A. 350-51 (Plan, art. 7.4(a)). *See also* J.A. 524-25 (Plan Appendix XVIII, art. 2(d)(1)) ("the Fifth Third Stock Investment Option . . . shall be one of the available

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[3] The Plan documents define the Plan as "a profit sharing plan except with respect to the following portions of the Plan which shall constitute a stock bonus plan and an employee stock ownership plan ("ESOP") as defined in section 4975(e)(7) of the [Internal Revenue] Code, designed to invest primarily in qualifying employer securities: (a) the portion of the Plan attributable to Employer matching contributions . . . [and] (e) effective December 31, 2001, the Fifth Third Stock Fund." J.A. 284-85 (Plan, art. 1.2).

investment options"); J.A. 599 (Plan Appendix XXI, art. 3(b)) (same); J.A. 500 (Plan Appendix XV, art. 5(b)) (same); J.A. 516 (Plan Appendix XVII, art. 11(b)) (same). The Plan documents formally designate this portion of the Plan as an ESOP. J.A. 284-85 (Plan, art. 1.2).

Eligible Fifth Third employees are permitted to make voluntary contributions to the Plan; they are free to direct these contributions to any of the Plan's 20 separate investment options, and are not obliged to select the Fifth Third Stock Fund. Pet. App. 30; J.A. 576-77 (Plan, Seventh Amendment art. 7.3) ("the Administrator shall direct the Trustee to make available at least three investment funds in addition to the Fifth Third Stock Fund"). Fifth Third also makes matching contributions of up to 4% of each employee's pre-tax compensation, which are initially invested in the Fifth Third Stock Fund. Pet. App. 30; J.A. 574-75, 576-77 (Plan, Seventh Amendment art. 4(a), 7.3). Plan participants have the sole discretion to buy, sell, or hold investments in the various options, allowing them (among other things) to immediately transfer any matching contributions initially invested in the Plan's ESOP component to another investment option. J.A. 576-77 (Plan, Seventh Amendment art. 7.3). Thus, all participants are free to buy, sell or hold Fifth Third stock indirectly by investing in (or by transferring out of) the Fifth Third Stock Fund. *Id*.

4. Respondents' Complaint. Respondents John Dudenhoeffer and Alireza Partovipanah are former employees of Fifth Third. J.A. 23-24 (¶¶ 26-27). During the financial crisis of 2008, respondents filed two separate class actions (later consolidated) against

Fifth Third Bancorp, Kevin T. Kabat and members of the Fifth Third Bank Pension, Profit Sharing and Medical Plan Committee (collectively, "petitioners") alleging violations of ERISA, pursuant to 29 U.S.C. § 1132(a)(2). J.A. 16 (¶ 1).

Respondents claim that petitioners breached their fiduciary duties by: (i) continuing to offer the Fifth Third Stock Fund as a Plan investment option when it was imprudent to do so during the financial crisis of 2008; (ii) continuing to invest Plan assets in Fifth Third stock; (iii) failing to divest the Plan of all Fifth Third stock; and (iv) engaging in this conduct when Fifth Third stock allegedly was an "imprudent investment." J.A. 53, 104 (¶¶ 100, 244).[4] Respondents proposed to bring these claims on behalf of themselves and other Plan participants seeking recovery for losses allegedly sustained by the Plan resulting from its investment in Fifth Third stock during the putative class period, *i.e.* from July 19, 2007 through the present. J.A. 19, 105 (¶¶ 13, 14, 246).

Respondents claim that petitioners had a fiduciary duty under ERISA to use material nonpublic information about Fifth Third for respondents' benefit. They allege that Fifth Third's "faulty business model" transformed the company from a conservative lender to a de facto subprime lender, which resulted in the

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[4] In addition to their "prudence" claim, respondents brought a "misrepresentation" claim – alleging petitioners breached their fiduciary duties under ERISA by incorporating by reference allegedly false and misleading SEC filings into plan documents – as well as additional derivative claims, none of which are before the Court.

"artificial inflation" of Fifth Third's stock price. J.A. 52-57 (¶¶ 96-112). They allege that overexposure to the declining housing and construction market, exposure to subprime loans, and mismanagement contributed to an "unacceptable level of risk borne by Plan participants, as a result of the Plan's investment in Fifth Third Stock." J.A. 54-55 (¶ 103). According to respondents, these risks were not disclosed to the public, but were known or should have been known to petitioners "[t]hrough their high-ranking positions within the Company." J.A. 87 (¶ 189). Respondents do not allege the magnitude of the "artificial inflation" of Fifth Third's stock price, nor do they make any allegations about the long-term prognosis for the stock or viability of the company.

Fifth Third's stock price declined substantially during 2008, but the company reported substantial profits in both 2007 and 2009 and its stock price "rebounded substantially" during the relevant period. Pet. App. 43.[5]

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[5] Respondents allege that the price of Fifth Third stock declined from $25.61 per share in December 2007 to a low of $2.85 per share on January 22, 2009. Pet. App. 43. The price of Fifth Third stock rebounded to $12.06 per share the day the district court issued its decision (November 24, 2010), $14.89 the day the Sixth Circuit issued its decision (September 5, 2012), $15.27 the day the Sixth Circuit denied rehearing and rehearing *en banc* (October 12, 2012), and $20.09 the day this Court granted certiorari (December 13, 2013). Historical Prices for Fifth Third Bancorp (FITB) Stock, Wall St. J., http://quotes.wsj.com/FITB/historical-prices (last visited Jan. 24, 2014). Fifth Third stock closed at $21.32 on January 24, 2014. *Id.*

5. The District Court's Decision. The district court granted petitioners' motion to dismiss the complaint for failure to state a claim. Pet. App. 28-52. The district court first held that "the Fifth Third Stock Fund plainly is an ESOP." Pet. App. 34. Applying the Sixth Circuit's decision in *Kuper v. Iovenko*, 66 F.3d 1447 (6th Cir. 1995), the district court then held that petitioners, as ESOP fiduciaries, are entitled to a presumption of reasonableness with respect to their decision to invest in employer stock. Pet. App. 37.

The district court held that, in order to state a claim for breach of fiduciary duty that would survive a motion to dismiss, respondents were required to plead facts sufficient to overcome the presumption of reasonableness by plausibly alleging that ESOP fiduciaries abused their discretion by remaining invested in employer stock. Pet. App. 37-38 (citing *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662 (2009)). The district court noted that other courts had reached the same conclusion. *Id*.

The district court held that the complaint failed to allege facts sufficient to overcome the presumption of reasonableness. Pet. App. 39-46. The complaint failed to "establish any facts which would have caused a reasonable fiduciary to cease offering Fifth Third stock as an investment option and/or divest Fifth Third stock from the Plan entirely." Pet. App. 45-46. The district court reasoned that: (i) the complaint demonstrates that Fifth Third remained viable despite a drop in its stock price; (ii) several large state pension funds actually increased their holdings in Fifth Third stock during the class period; (iii) Fifth Third's stock price rebounded substantially during the class period; and

(iv) the allegations in the complaint challenged Fifth Third's business judgment, which is not actionable under ERISA. Pet. App. 44-47.

The district court held that respondents' allegation that Fifth Third's stock price was "artificially inflated" during the class period did not change the outcome, because "there is no principled difference between how a fiduciary should respond to 'artificial inflation' of the stock price as opposed to other sorts of negative insider information." Pet. App. 46 (citing *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 254 (5th Cir. 2008)). The presumption of reasonableness "logically applies to any allegations of fiduciary duty breach for failure to divest an EIAP or ESOP of company stock," as the standard of review of such decisions does not turn on "pleading artifices." *Id*. The district court therefore dismissed respondents' breach of fiduciary duty claim to the extent it relied on the continued offering of, and failure to divest the Plan of, Fifth Third stock. Pet. App. 47.[6]

6. The Court of Appeals' Decision. The Sixth Circuit reversed. Pet. App. 1-25. The court of appeals recognized that its prior decisions acknowledged and applied a presumption of reasonableness to an ESOP fiduciary's decision to invest in employer stock, but the court of appeals concluded that the presumption does not apply at the motion to dismiss stage. Pet. App. 11-13 (citing *Pfeil v. State St. Bank & Trust Co.*, 671 F.3d

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[6] The district court also dismissed respondents' "misrepresentation" claim and their derivative claims, which are not presently before the Court; the Sixth Circuit reversed the dismissal of these claims.

585 (6th Cir. 2012)). The court of appeals acknowledged that other "circuits have reached a different conclusion." Pet. App. 12. To reach a contrary result, the Sixth Circuit recast the presumption of reasonableness as an evidentiary presumption rather than a standard of review, and held that application of the presumption requires a fully developed evidentiary record that does not exist at the pleading stage. Pet. App. 11-12.

The court of appeals further held that plausible allegations that an ESOP fiduciary abused its discretion by continuing to invest in employer stock are not necessary to state a breach of fiduciary duty claim under ERISA. Pet. App. 12-13. Instead, the Sixth Circuit held that "*all* fiduciaries, including ESOP fiduciaries" are subject to "identical standards of prudence and loyalty," describing an "equality of standard" for all fiduciaries. Pet. App. 12-13. Thus, plaintiffs challenging an ESOP fiduciary's decision are required to allege only that "a prudent fudiciary acting under similar circumstances would have made a different investment decision." Pet. App. 12. The court of appeals concluded that "if a 'prudent man acting in a like capacity and familiar with such matters' would not have undertaken that conduct at issue, then an ESOP or any other fiduciary may not do so." Pet. App. 13.

Petitioners filed a petition for rehearing and rehearing en banc, which the Sixth Circuit denied. Pet. App. 53-54.

SUMMARY OF ARGUMENT

1. ESOPs are unique, "designed to invest primarily in qualifying employer securities," and favored by Congress because of that purpose. 29 U.S.C. § 1107(d)(6)(A). When a plaintiff challenges an ESOP fiduciary's decision to invest in employer securities – that is, to do exactly what the terms of the plan require – the plaintiff has a difficult burden. To establish a violation of ERISA's duty of prudence, the plaintiff must overcome the substantial deference owed the fiduciary, typically expressed as a presumption of prudence. Specifically, the plaintiff cannot prevail unless extraordinary circumstances, such as a serious threat to the employer's viability, mean that continued investment would substantially impair the purpose of the plan. That deferential standard is required by the text of ERISA, is derived from trust law, and is necessary to further Congress's purposes and to avoid unnecessary conflicts with the federal securities laws.

a. The court below's insistence on a single, inflexible standard of prudence, applicable to ESOPs and non-ESOPs alike, is inconsistent with the statutory text. ERISA defines the duty of prudence based on how a prudent man would act "in the conduct of an enterprise *of a like character and with like aims*." 29 U.S.C. § 1104(a)(1)(B) (emphasis added). An ESOP's purpose is to allow employees to build a long-term ownership stake in their employer. A prudent person responsible for an enterprise with the character and aims of fostering employee ownership of one company would not divest that company's securities simply because its share price fell. Moreover, section 1104(a)(1)(D) separately expresses Congress's intent

that fiduciaries generally adhere to the terms of the plan. A robust presumption that ESOP fiduciaries have acted prudently in investing in employer securities, subject to rebuttal based only on extraordinary circumstances threatening the plan's purpose of fostering employee ownership over the long term, flows directly from this statutory scheme.

b. Trust law confirms this standard and supplies guidance on how it applies. Under trust law, the prudence of an investment decision depends on the particular provisions and circumstances of the trust. While the prudent investor generally adheres to the trust's investment instructions, the "deviation doctrine" allows for departures where, because of a change of circumstances, compliance would substantially impair the accomplishment of the trust's purposes. These principles appropriately inform the correct standard of review for ESOP fiduciaries. Since the fundamental purpose of an ESOP is to build employees' equity interest in their employer, a mere decline in stock price does not substantially impair the plan's purposes. By contrast, if there is a serious threat to the company's ongoing viability, continued investment in its securities may no longer advance the plan's primary purpose, because a collapse would leave employees with no meaningful ownership interest in their employer. Applying trust law principles, liability for a violation of the duty of prudence by an ESOP fiduciary is limited to such extraordinary circumstances.

c. Congress's emphatic purpose of promoting employee ownership through ESOPs further supports a robust presumption of prudence. The structure of ERISA, combined with incentives in the tax code, make

clear Congress's policy of favoring ESOPs. That purpose is revealed not just in legislative history, but in statutory text: in the Tax Reform Act of 1976, Congress expressly stated ERISA's purpose of "encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system"; emphasized that ESOPs should not be "treat[ed]" like "conventional retirement plans"; and warned against rulings that could "block the establishment and success of these plans." Pub. L. No. 94-455, § 803(h). A standard of prudence requiring a fiduciary to abandon investment in employer securities because of a drop in stock price would defeat Congress's purpose.

More broadly, a less deferential standard would undermine Congress's policy of encouraging employers to voluntarily offer ESOPs. Absent a strong presumption of prudence, an ESOP fiduciary would be placed "on a razor's edge," subject to lawsuits for buying and holding employer securities (for purported violations of the duty of prudence), and equally subject to lawsuits for *selling* those securities (for failure to adhere to the terms of the plan) if they recover in value. *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006). Allowing this costly result would not benefit employees, who in most plans, including Fifth Third's, are free to avoid the risks inherent in ESOPs and to elect to invest in diversified investment options. The Sixth Circuit's standard would instead undermine Congress's intent by dissuading employers from offering these plans. *See Conkright v. Frommert*, 559 U.S. 506, 516-17 (2010).

d. Insufficient deference to ESOP fiduciaries would also result in an avoidable collision between ERISA and the federal securities laws. Respondents' theory, representative of the typical ESOP "stock drop" case, is that petitioners failed to use material nonpublic information for plan participants' benefit. But that is unlawful insider trading; ERISA need not and should not be interpreted to require what the securities laws forbid. To be sure, an ESOP fiduciary in possession of material nonpublic information could lawfully cease making new investments or make the adverse information public, but these half-measures would be unavailing. Were an ESOP simply to cease making new investments in employer securities, that would likely spark a negative market reaction, damaging the value of the securities the plan already holds. Disclosing adverse information would also not help plan participants, since the market would adjust: the ESOP would be able to diversify its holdings of employer securities only at a non-inflated price, and the disclosure would therefore not aid participants. Moreover, Congress cannot have intended ERISA to have far-reaching ripple effects on corporate disclosures.

2. For the reasons explained above, ERISA strictly limits the circumstances in which an ESOP fiduciary's decision to invest in employer securities can be deemed imprudent. If a plaintiff cannot plausibly allege facts showing extraordinary circumstances that would render an investment decision imprudent *in the context of an ESOP*, she has not stated a viable claim. This result does not change simply because courts have referred to this deferential standard as a "presumption." This Court and others have frequently

applied presumptions at the pleading stage where the plaintiff has not alleged facts sufficient to overcome the presumption and to establish entitlement to relief. While some presumptions have limited evidentiary purposes, others impose a heavy burden of persuasion and apply at the pleading stage. Properly understood, the presumption of prudence is the latter kind: it expresses the substantive standard ERISA requires plaintiffs to meet to establish a breach of the duty of prudence. There is no reason to allow a plaintiff whose allegations do not meet the substantive standard of liability to proceed to expensive discovery.

3. Measured against the correct legal standard, respondents' pleadings cannot survive a motion to dismiss. They allege that petitioners knew or should have known that Fifth Third's stock price would fall, and that in these circumstances it was imprudent not to divest. But they allege no facts that would plausibly show that continued investment would substantially impair the purpose of the ESOP, *i.e.*, long-term investment in Fifth Third. Absent allegations meeting this standard, petitioners satisfied the duty of prudence as a matter of law, and the complaint must therefore be dismissed.

ARGUMENT

I. An ESOP Fiduciary's Decision To Continue Investing In Employer Securities Is Presumptively Prudent Absent Extraordinary Circumstances That Make The Decision Inconsistent With The ESOP's Purposes.

ESOPs are unique. Recognized and encouraged by Congress, ESOPs are designed for the express purpose of investing in employer securities. Consistent with this stated purpose, the law does not regard ESOPs "as conventional retirement plans," which are designed solely for the purpose of providing retirement benefits and not for the purpose of developing an equity stake in a particular company. Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h). Indeed, Congress has declared that ESOPs should not be treated as conventional retirement plans, lest such treatment "block the establishment and success of these plans." *Id.*

The unique character and aims of ESOPs have important consequences under ERISA. For example, the acquisition or holding of qualifying employer securities by ESOPs and other EIAPs are exempt from the otherwise applicable 10% limit on investment in employer securities, 29 U.S.C. § 1107(a), as well as the requirement to "diversify[ ] the investments of the plan so as to minimize the risk of large losses," *id.* § 1104(a)(1)(C). *See id.* §§ 1104(a)(2), 1107(b). Congress also exempted the acquisition or holding of qualifying employer securities by ESOPs and other EIAPs from "the prudence requirement (only to the extent it requires diversification)." *Id.* § 1104(a)(2).

Because Congress did not waive the duty of prudence entirely, courts have had to determine how that duty applies to ESOP fiduciaries. As this Court has explained, ERISA requires the federal courts to elaborate on the duty of prudence and other fiduciary duties "as they develop a federal common law of rights and obligations under ERISA-regulated plans." *Varity Corp. v. Howe*, 516 U.S. 489, 496-97 (1996) (quoting *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1987)) (internal quotation marks omitted). Over the past twenty years, courts of appeals have done exactly that, ruling that a deferential standard of review is required in applying the duty of prudence to ESOP fiduciaries.

Beginning with *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), the courts of appeals have applied a deferential of standard of review through a presumption that an ESOP fiduciary's decision to invest in employer securities is reasonable and proper. *See White v. Marshall & Ilsley Corp.*, 714 F.3d 980, 988-91 (7th Cir. 2013); *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1280-81 (11th Cir. 2012); *In re Citigroup ERISA Litig.*, 662 F.3d 128, 140 (2d Cir. 2011), *cert. denied*, 133 S. Ct. 475 (2012); *Quan v. Computer Scis. Corp.,* 623 F.3d 870, 882 (9th Cir. 2010); *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 253-56 (5th Cir. 2008); *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995).[7] Nearly all of these courts have concluded that

[7] In granting certiorari, the Court did not accept the Government's suggestion to re-write the question presented to consider whether ESOP fiduciaries should be accorded a presumption that continuing to invest in employer securities is prudent. *See* U.S. Cert. Br. 19. The following discussion of the question presented

plaintiffs bear a heavy burden in overcoming this presumption, holding that an ESOP fiduciary's decision to continue investing in employer securities is not imprudent absent extraordinary circumstances such as the "impending collapse" of the company. *See, e.g.*, *Quan*, 623 F.3d at 882.

The decision below, however, allows plaintiffs to rebut the presumption merely by showing that "a prudent fiduciary acting under similar circumstances would have made a different investment decision." Pet. App. 11 (quoting *Kuper*, 66 F.3d at 1459). The court of appeals refused to tailor its standard to the special statutory context and purpose of ESOPs, instead holding that ERISA "imposes identical standards of prudence and loyalty on *all* fiduciaries." Pet. App. 13. As a result, the court treated an ESOP fiduciary's decision to invest in employer securities as subject to the same standard of review as any other fiduciary decision with respect to any other investment under any other plan.

This result is inconsistent with the deferential standard of review required by ERISA. When a plaintiff challenges an ESOP fiduciary's decision to invest in employer securities, that decision is presumptively prudent – that is, it satisfies the statutory duty of prudence – unless the plaintiff can

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nevertheless describes the source of the presumption, and explains that the presumption has not been judicially "imposed" based solely on "policy considerations," U.S. Cert. Br. 11. *See infra* Parts I.A-D. Moreover, "[t]he very strength of th[e] consensus" among lower courts on the existence and validity of the presumption "supports adherence to the traditional view." *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 593-94 (2004).

establish extraordinary circumstances that make continued investment in employer securities fundamentally inconsistent with the purposes of the plan. For example, 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. A mere drop in stock price based upon business or market-wide fluctuations, by contrast, does not render continued investment fundamentally inconsistent with the objective of building employee ownership over the long term. Thus, the statutory duty of prudence does not require a fiduciary to cease investing in employer securities solely because of a drop in stock price.

As we explain below, ERISA requires courts to apply a highly deferential standard in reviewing the prudence of an ESOP fiduciary's continued investment in employer securities. *First*, a deferential standard of review conforms to the statutory text. Congress expressly provided that the content of the duty of prudence is informed by the "character" and "aims" of the plan. This language requires a strong presumption that an investment decision is prudent when the very character and aims of the plan are defined by that particular ERISA-sanctioned investment. *Second*, the standard is supported by trust law. Under trust law, the terms of a trust modify the duty of prudence, and a trustee can depart from investment instructions set forth in the trust instrument only when faced with a substantial impairment of the trust's purposes. Both of these principles properly inform an ESOP fiduciary's duty of prudence under ERISA. *Third*, the importance of substantial deference for ESOP fiduciaries is

bolstered by the policies and purposes of ERISA. One of Congress's key objectives was to encourage employers to offer voluntary retirement plans in general, and ESOPs in particular. Without substantial deference to their decisions, ESOP fiduciaries will frequently find themselves "on a razor's edge," subject to one lawsuit if they buy (or continue to hold) and another suit if they sell. *Armstrong*, *v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006). *Finally*, insufficient deference to ESOP fiduciaries would create a collision with the federal securities laws, requiring fiduciaries to either engage in prohibited insider trading or take self-defeating half-measures. ERISA can and should be interpreted to be in harmony with securities law, not at war with it.

A. A Robust Presumption Of Prudence Is Required By The Terms Of ERISA.

ERISA requires plan fiduciaries to discharge their duties

> with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise *of a like character and with like aims*[.]

29 U.S.C. § 1104(a)(1)(B) (emphasis added).

The Sixth Circuit's insistence on an "equality of standard" for all plans and all investment decisions, Pet. App. 13, is inconsistent with this statutory language. Congress expressly directed that the prudence of an investment decision be evaluated not by applying some abstract standard of sound investment

management, but by making a context-specific comparison to "an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B). *See also* Hearings on H.R. 1045, H.R. 1046, and H.R. 16462 Before the Subcomm. on Gen. Labor of the House Comm. on Ed. & Labor, 91st Cong. 1st & 2d Sess. 467 (Apr. 16, 1970) (testimony of Secretary of Labor George P. Shultz) (hereinafter "Shultz Testimony") (explaining that the text of ERISA's prudence standard has "built-in flexibility" requiring a court to take into account the "goals of the plan").[8]

The core characteristic of ESOPs is that they are, by definition, "designed to invest primarily in qualifying employer securities." 29 U.S.C. § 1107(d)(6)(A). Congress has specifically distinguished this unique purpose of "bringing about stock ownership by all corporate employees" from that of "conventional retirement plans." Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h). ESOPs are "designed to build equity ownership of shares of the employer corporation." H.R.

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[8] *See also* 29 C.F.R. § 2550.404a-1(b)(1) ("With regard to an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to his investment duties, the requirements of [29 U.S.C. § 1104(a)(1)(B)] . . . are satisfied if the fiduciary (A) has given appropriate consideration to the facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, *including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties, and (B) has acted accordingly*" (emphasis added)); *id.* § 2550.404a-1(b)(2) (appropriate consideration includes whether the investment "further[s] the purposes of the plan").

Rep. No. 93-1280, at 313 (1974) (Conf. Rep.); *see also* Senate Special Committee on Aging, Developments in Aging: 1989, S. Rep. No. 101-249, at 94 (1990) ("Employee stock ownership plans were promoted as a means for transferring the ownership of a company's capital to its workers."). Although ESOPs "can become a valuable source of retirement income to supplement Social Security, pension benefits and personal savings, they are not designed (or intended) to be an employee's sole or primary retirement savings vehicle." *Id.*; *see also* Staff of S. Committee on Finance, Employee Stock Ownership Plans, 96th Cong., 2d Sess. 27 (Comm. Print 1980) (noting "Congressional intent that an ESOP is not primarily a retirement plan, but rather has as its primary objective the providing of stock ownership interests for employees").

In the terms of section 1104(a)(1)(B), the "character" of an ESOP is a vehicle for making one particular investment, and its "aim" is to foster employees' ownership stake in the company they work for. An ESOP fiduciary's duty of prudence is therefore to act as a prudent person would in conducting an enterprise with a similarly restricted investment agenda and a similar purpose of building equity in one specific company.

Because ERISA's duty of prudence is attuned to the "character and aims" of a plan, a fiduciary of an ordinary retirement plan might act imprudently by investing in a particular company, but act prudently by making the same investment for an ESOP. Indeed, it will be the rare case when an ESOP fiduciary acts imprudently by doing precisely what the plan was "designed" to do. 29 U.S.C. § 1107(d)(6)(A). For

example, a prudent fiduciary managing an enterprise whose express purpose is holding a particular security as a long-term investment would not necessarily divest that security simply because its price fell. Indeed, that long-term strategy might be furthered by buying the security at what proves to be a bargain price – Fifth Third stock purchased at its lowest point, for example, has since increased in value more than seven-fold. *Supra* p. 12, n. 5. It would take a more extreme change in circumstances, such as a serious threat to the continued viability of the company, to conclude that a prudent fiduciary of *this type* of enterprise would divest the stock.

The character of the plan is relevant in another important respect: the Fifth Third Plan, like many 401(k) plans, offers employer stock as one investment option, and allows participants to opt out of building an equity stake in their employer at any time. Thus, if a Fifth Third employee's individual circumstances counsel against the risk of large losses inherent in undiversified investments, she has ample alternatives. In reality, respondents' claim is not that petitioners invested their funds imprudently, but that petitioners "acted imprudently *by allowing employees* to choose to buy and hold an employer's stock." *White*, 714 F.3d at 981 (emphasis added). Since the prudent fiduciary would take the availability of employee choice into account, this additional aspect of the "character" of the Fifth Third ESOP (and many like it) bolsters the case for substantial deference to ESOP fiduciaries.

This interpretation of the duty of prudence as it applies to ESOP fiduciaries is bolstered by section 1104(a)(1)(D). That provision requires fiduciaries to

act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with this subchapter and subchapter III of this chapter." To be sure, in the case of a *true* conflict, plan terms that are inconsistent with the fiduciary's statutory duties cannot be enforced. But whereas the Government leaps to find conflict to justify departures from an ESOP's terms, U.S. Cert. Br. 11-12, the proper approach is to avoid conflict if possible and to give meaning to both parts of the statute. *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) (parts of a statute should, "if possible," be read as a "harmonious whole" (citation and internal quotation marks omitted)). Since Congress expressly provided that the duty of prudence takes into account the "character and aims" of a plan, ESOP fiduciaries typically can comply with both subsection (a)(1)(B) and subsection (a)(1)(D) by adhering to the terms of the plan. *See also infra* Part I.B (explaining that under trust law, the terms of the trust modify and inform the duty of prudence).[9]

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[9] The Government also argues that "[b]y preserving the duty of prudence for ESOPs *except* insofar as it requires diversification, Congress expressed its intent that the same general standard of prudence would govern ESOP fiduciaries as other ERISA fiduciaries." U.S. Cert. Br. 11. That argument makes a basic logical error. It follows from Congress's decision to *exempt* ESOP fiduciaries from only a portion of the prudence requirement that those fiduciaries remain subject to the general duty; petitioners do not contend otherwise. It does not follow, however, that the *content* of that duty is unaffected by the purposes of the Plan at issue. Petitioners' view of the statute gives full effect to the diversification exemption and its limits, recognizing that the duty of prudence continues to apply to ESOPs. The Government, by contrast, reads the "character and aims" language out of the

In sum, Congress has crafted a regime that requires interpreting the duty of prudence based on the character and aims of the plan at issue. Because the fundamental purpose of an ESOP is to foster employee ownership through investment in employer securities, a presumption that ESOP fiduciaries have acted prudently by investing in such securities, subject to rebuttal based only on extraordinary circumstances threatening the plan's purpose (in trust law terms, the "settlor's intent"), flows directly from this statutory scheme.

B. A Robust Presumption Of Prudence, And The Substantive Standard For Overcoming It, Are Derived From Trust Law.

This Court has recognized that ERISA's "fiduciary duties," including "th[e] prudent man rule," "draw much of their content from the common law of trusts." *Varity Corp.*, 516 U.S. at 496-97; *see also Conkright*, 559 U.S. at 512 (explaining that the court "look[s] to" trust law for "guidance" when "ERISA's text does not directly resolve the matter"). Trust law confirms the need for a distinct standard of prudence for ESOPs, and supplies guidance on how that standard should be applied.

As explained above, the text of section 1104(a)(1)(B) requires the duty of prudence to be applied in light of the "character and aims" of the plan. Trust law confirms this principle. The Restatement explains that

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statute by assuming that, whenever the duty applies, it must apply in the same way, regardless of the character and aims of the plan.

a trustee must act "as a prudent investor would, *in light of the purpose, terms*, distribution requirements, and other circumstances of the trust." Restatement (Third) of Trusts § 90 (emphasis added); *see also* Uniform Trust Code § 804 ("A trustee shall administer the trust as a prudent person would, *by considering the purposes, terms*, distributional requirements, and other circumstances of the trust." (emphasis added)). In other words, the trustee's performance must be evaluated not by comparing her performance to some abstract ideal of "prudence," but rather by determining what is prudent under the particular provisions and circumstances of the trust.[10]

While a prudent fiduciary *generally* adheres to the specific terms of the trust, trust law also establishes a standard for departing from those terms (the "deviation

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[10] Although trust law and ERISA reach essentially the same result in circumstances like those presented here, they do so by slightly different paths. The traditional articulation of the trust law standard of prudence is that trustees must "observe how men of prudence, discretion and intelligence manage their own affairs." *Harvard College v. Amory*, 26 Mass. 446, 461 (1830). By contrast, the ERISA standard of prudence was intentionally drafted to be more flexible. *See* Shultz Testimony at 467. Although the traditional trust law standard does not expressly refer to the character and aims of the trust, trust law reaches essentially the same result by applying a rule that "the settlor can reduce or waive the prudent man standard of care by specific language in the trust instrument." George Gleason Bogert et al., Law of Trusts and Trustees § 541. While ERISA does not allow an employer to reduce or waive the statutory duty of prudence, 29 U.S.C. § 1104(a)(1)(D), the common denominator under both ERISA and trust law is that a fiduciary's decision cannot be deemed imprudent without considering the terms and purposes of the trust.

doctrine"). Although specific investment instructions are "*presumptively* valid," they can be overcome due to "changed circumstances." John H. Langbein & Richard A. Posner, Trust-Investment Law: II, 1977 Am. B. Found. Res. J. 1, 34 (emphasis added).[11] This exception, however, is strictly circumscribed: "trust provisions . . . generally control, unless compliance is impossible or illegal or there has been such a change of circumstances that compliance would defeat or substantially impair the accomplishment of the trust purposes." 4 A. Scott, W. Fratcher & M. Ascher, Scott and Ascher on Trusts § 19.1.2, p. 1419 (5th ed. 2007); Restatement (Second) of Trusts § 167 ("The court will direct or permit the trustee to deviate from a term 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.").[12]

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[11] Even in these circumstances, judicial authorization typically is required before a trustee abandons a term of the trust. That requirement makes it even more difficult to depart from investment directions contained in the trust. In light of ERISA's purpose of avoiding costly litigation, however, no one has suggested that an ESOP fiduciary must seek judicial approval prior to reducing investment in employer securities in appropriate circumstances.

[12] The Third Restatement expresses this doctrine in arguably broader language, permitting deviations that "will further the purposes of the trust." Restatement (Third) of Trusts § 66(1). To the extent trust law has changed, courts should be guided by the common law as it stood when Congress enacted ERISA. *See Moench*, 62 F.3d at 571 & n.6. The Second Restatement's formulation of the doctrine also better serves the purposes of ERISA with respect to ESOPs. *See infra* Part I.C. In any event,

The famous case of Joseph Pulitzer's trust illustrates the application of, and inherent limitations on, trust law's deviation doctrine. *In re Pulitzer's Estate*, 249 N.Y.S. 87 (Surr. Ct. 1931), *aff'd. sub nom In re Pulitzer,* 260 N.Y.S. 975. (App. Div. 1932). Pulitzer's will established a trust with the instruction that the stock of his favorite newspaper, *The New York World*, not be sold. *Id.* at 92. However, circumstances changed such that continued publication of the newspaper "will in all probability lead to a serious impairment or the destruction of a large part of the trust estate." *Id.* at 94. Under these "extraordinary circumstances," the court concluded that Pulitzer's "dominant purpose" of providing continuing income to his family should be furthered rather than allow "the entire trust asset [to be] destroyed or wrecked by bankruptcy or dissolution." *Id.* at 93-95. Significantly, this result was based on both "extraordinary circumstances" threatening bankruptcy, as well as the court's finding that Pulitzer's goal of continued investment in the *World* was merely subsidiary to his "dominant purpose" of providing continuing income for his family.

The Court can appropriately look to these trust law principles in determining the correct standard of review for ESOP fiduciaries. *See Moench*, 62 F.3d at 571-72. Consistent with trust law, an ESOP fiduciary's decision to adhere to the terms of the plan and invest in employer securities should generally be deemed

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since the core purpose of an ESOP is investment in employer securities, extraordinary circumstances would be necessary to establish that ceasing to invest in employer securities would "further the purposes of the [plan]."

prudent. Also consistent with trust law, prudence dictates deviation from the plan's instructions only when changed circumstances threaten to "defeat or substantially impair" the purposes of the trust.

The fundamental purpose of an ESOP (*i.e.*, the intent of the settlor) is to build employees' equity interest in their employer through investment in its securities. 29 U.S.C. § 1107(d)(6)(A); *see supra* Part I.A. Since a mere decline in stock prices, even a substantial one, does not pose a long-term threat to this purpose, continued investment in employer securities is not imprudent. Indeed, in exempting ESOP fiduciaries from the duty to diversify investments "so as to minimize the risk of large losses," Congress plainly contemplated that ESOPs would be subject to the risk of substantial declines in stock prices. 29 U.S.C. §§ 1104(a)(1)(C), (a)(2). The result could be different if there were a serious threat to "the company's viability as an ongoing concern," or a "precipitous decline in the employer's stock" were "combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement." *Quan*, 623 F.3d at 882 (citation and internal quotation marks omitted). 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. It is therefore only in rare and extraordinary circumstances, and not 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.

C. A Robust Presumption Of Prudence Advances Fundamental Goals Of Employee Benefits Law.

In interpreting ERISA's fiduciary duties, this Court also looks to the "guiding principles . . . underlying ERISA." *Conkright*, 559 U.S. at 516; *see also Varity Corp.*, 516 U.S. at 497 (after consulting trust law to "inform . . . an effort to interpret ERISA's fiduciary duties," "courts must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements"). Here, Congress's emphatic policy of promoting employee stock ownership through ESOPs supports a highly deferential standard of review for ESOP fiduciaries.

As the courts of appeals have unanimously recognized, "Congress has repeatedly expressed its intent to encourage the formation of ESOPs by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that goal." *Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983). The structure of ERISA demonstrates Congress's policy of promoting ESOPs by relieving them of various restrictions. *See* 29 U.S.C. § 1104(a)(2) (exemption from the duty to diversify); *id.* § 1107(b) (exemption from 10% limit on investment in employer securities); *id.* § 1108(b)(3) (permitting ESOPs to borrow from employer to fund investment in employer stock); *id.* § 1108(e) (exemption from restriction on transactions between plan and sponsoring employer for purchases

and sales of employer securities).[13] The Internal Revenue Code also offers tax incentives for employers to maintain plans that invest in employer stock. *See, e.g.*, 26 U.S.C. § 404(k) (deductible dividends on employer stock held by ESOP); *id.* § 402(e)(4) (preferential tax treatment for distributions of appreciated employer stock); *id.* § 1042 (deferring tax on gain from sale of employer stock to ESOP).[14]

ERISA's legislative history confirms the statutory purpose of promoting employee stock ownership. *See supra* pp. 25-27. Even more to the point, two years

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[13] These features were the result of Congress's considered judgment. ERISA was enacted "following almost a decade of studying the Nation's private pension plans." *Nachman Corp. v. Pension Benefit Guar. Corp.*, 446 U.S. 359, 361 (1980). Congress adopted many of the recommendations made in a 1965 report to President Johnson by a Cabinet-level committee. *See* President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs, Public Policy and Private Pension Programs: A Report to the President on Private Employee Retirement Plans (1965). ESOPs, however, were an important exception: Congress rejected recommendations to repeal favorable tax treatment for distributions of appreciated employer stock and to impose an across-the-board 10% limit on the portion of plan assets that could be invested in employer stock, *id.* at xiii & xvi, deciding instead to promote ESOPs and EIAPs.

[14] Congress has continued to legislate regarding employee stock ownership. The Pension Protection Act of 2006, for example, requires certain plans to provide participants with the right to diversify their investments. *See* Pub. L. No. 109-280, §§ 507-09, 621, 901, 120 Stat. 780, 948-52, 978-79, 1026-033. Thus, Congress has recognized the risks that come with the benefits of ESOPs, and has addressed those risks through employee choice, not by placing ESOP fiduciaries in an untenable position.

after enacting ERISA, Congress codified by statute its goals with respect to ESOPs:

> INTENT OF CONGRESS CONCERNING EMPLOYEE STOCK OWNERSHIP PLANS
>
> The Congress, in a series of laws (the Regional Rail Reorganization Act of 1973, *the Employee Retirement Income Security Act of 1974*, the Trade Act of 1974, and the Tax Reduction Act of 1975) and this Act has made clear its *interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system* which will solve the dual problems of securing capital funds for necessary capital growth and of *bringing about stock ownership by all corporate employees.* The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by *regulations and rulings which treat employee stock ownership plans as conventional retirement plans*, which reduce the freedom of the employee trust and employers to take the necessary steps to implement the plans, and which otherwise *block the establishment and success of these plans*. Because of the special purposes for which employee stock ownership plans are established, it is consistent with the intent of Congress to permit these plans (whether structured as pension, stock bonus, or profit-sharing plans) to distribute income on employer securities currently.

Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h) (emphases added).[15] *Cf. FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) ("[T]he meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand."); *FHA v. The Darlington, Inc.*, 358 U.S. 84, 90 (1958) ("Subsequent legislation which declares the intent of an earlier law . . . is entitled to weight when it comes to the problem of construction.").

Congress's purpose of encouraging stock ownership confirms the need for a robust presumption and supports the trust law-derived standard needed to overcome it: plaintiffs must establish that continued investment would substantially impair the purposes of the plan. The goal of employees "build[ing] equity ownership of shares in the employer corporation," H.R. Rep. No. 93-1280, at 313, is inherently a long-term proposition. If the employer's stock price drops in the short-term due to adverse business developments, the virtues of building employee equity over a longer time horizon are ordinarily still achievable and worthwhile. Moreover, even if holding employer stock were not an end in itself, it would be fruitless to attempt to "outsmart the stock market" through short-term speculation. *White*, 714 F.3d at 982. A fiduciary that

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[15] In addition to Congress's philosophical reasons for favoring employee ownership, the leading congressional advocates for ESOPs also pressed a functional case: "companies with employee ownership are likely to be more productive and more profitable than those without, and the more ownership held by employees, the better the performance of the company." 129 Cong. Rec. 33,814 (1983) (statement of Sen. Russell Long).

does so might well miss an opportunity to accumulate employer securities at what proves to be a bargain price, and to profit when that stock rebounds (as Fifth Third stock has done here, *supra* p. 12, n.5). Accordingly, a standard of prudence requiring the fiduciary to abandon investment in employer securities simply because of a short-term drop in stock price is inconsistent with Congress's purposes.

More broadly, a less deferential standard would undermine Congress's purpose of encouraging employers to voluntarily offer ESOPs. *See Conkright*, 559 U.S. at 516-17 ("Congress did not require employers to establish benefit plans in the first place," and so sought to "induc[e] employers to offer benefits by assuring a predictable set of liabilities"); *Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 148 n.17 (1985) ("Congress was concerned lest the cost of federal standards discourage the growth of private pension plans.").[16] In the ESOP context, Congress specifically warned against "rulings which treat employee stock ownership plans as conventional retirement plans" and

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[16] *See also* H.R. Rep. No. 93-807, at 2 (1974) ("[P]rivate retirement plans are voluntary on the part of employers, and, therefore, it has weighed carefully the additional costs to the employers and minimized these costs to the extent consistent with minimum standards for retirement benefits."); H.R. Rep. No. 93-779, at 2 (1974) (same); *see also* H.R. Rep. No. 93-533, at 2 (1973) ("The bill is designed to . . . promote a renewed expansion of private retirement plans and increase the number of participants receiving private retirement benefits."); S. Rep. No. 93-383, at 10-11 (1973) (bill encourages voluntary establishment of retirement plans); S. Rep. No. 93-127, at 13-14 (1973) (bill strikes "an appropriate balance" between employers' and labor organizations' interest in design flexibility and workers' need for adequate protection).

thereby "block the establishment and success of these plans." Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h). If plaintiffs who bring lawsuits like this one are allowed to proceed without pleading facts sufficient to overcome a robust presumption of prudence, ESOP fiduciaries will be placed in an untenable position. On the one hand, they will face litigation for allegedly violating the duty of prudence if they do not dispose of employer stock when its price drops. On the other hand, they will face litigation under section 1104(a)(1)(D) if they override the terms of the plan by halting the purchase of employer stock or by liquidating the plan's holdings of employer stock.

Two cases involving the W.R. Grace 401(k) plan demonstrate that this predicament is not hypothetical: the plaintiffs in one case alleged that the plan fiduciaries had violated their duties by allowing the plan to invest in W.R. Grace stock for too long, *Evans v. Akers*, 534 F.3d 65, 68 (1st Cir. 2008); the plaintiffs in the other case complained that the fiduciaries had caused the plan to sell W.R. Grace stock too soon, before its price increased substantially, *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 2-3 (1st Cir. 2009). *See also Summers v. State St. Bank & Trust Co.*, 453 F.3d 404, 411 (7th Cir. 2006) ("[I]f State Street had sold earlier and the stock had then bounced back, as American Airlines' stock did, State Street might well have been sued by the same plaintiffs . . . ."). The result is to "seat ESOP trustees on a razor's edge," *Armstrong*, 446 F.3d at 733, and treat them as "virtual guarantors of the financial success of the . . . plan," *Moench*, 62 F.3d at 570 – at risk if they permit continued investment in employer stock, and equally at risk if they do not. The

history of Fifth Third's stock price epitomizes this dilemma. *See supra* p. 12, n.5.

Placing fiduciaries in an untenable position is unlikely to benefit employees – who, it should be recalled, are typically given "the responsibility and freedom to choose" whether to invest in an ESOP or a more conservative option. *White*, 714 F.3d at 994. Employers are likely to pay for increased litigation costs by diverting funds that would otherwise be used to provide additional benefits, or opting out of the voluntary benefits system altogether. *Cf. Cooper v. IBM Pers. Pension Plan*, 457 F.3d 636, 642 (7th Cir. 2006) ("It is possible, though, for litigation about pension plans to make everyone worse off."). Congress did not intend to erect a regime "so complex that administrative costs, or litigation expenses, unduly discourage employers from offering [ERISA] plans in the first place." *Conkright*, 559 U.S. at 517 (quoting *Varity Corp.*, 516 U.S. at 497) (alteration in original).

Notably, this Court in a related line of cases has interpreted ERISA to require a deferential standard of review for plan fiduciaries' interpretation of plan terms, emphasizing that such deference advances important congressional purposes. *See Conkright*, 559 U.S. at 516-17; *Firestone*, 489 U.S. at 111. Although these cases arose in the context of interpretation of plan terms, this Court has explained that *Firestone* deference is based "upon the same common-law trust doctrines that govern standards of fiduciary conduct." *Varity Corp.*, 516 U.S. at 514-15. As the Court explained, "[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to

prevent an abuse by the trustee of his discretion." *Firestone*, 489 U.S. at 111 (quoting Restatement (Second) of Trusts § 187) (internal quotation marks omitted). In an ESOP, the plan grants the fiduciary not just the *discretion* to invest in employer securities, but the *instruction* to do so. *A fortiori*, substantial deference to the fiduciary's decision to adhere to the plan is required.

D. Insufficient Deference To ESOP Fiduciaries Would Give Rise To Unintended And Avoidable Conflicts With Securities Law.

In addition to advancing the purposes of ERISA, substantial deference to ESOP fiduciaries is necessary to avoid a collision with the federal securities laws. Congress could not have intended for an ESOP fiduciary's duties to be construed so broadly as to require them to engage in insider trading. Yet that and other anomalies are the practical effect of the Sixth Circuit's non-deferential approach to the presumption of prudence.

Respondents' theory, representative of the typical ESOP "stock drop" case, is that petitioners failed to take into account material nonpublic information about Fifth Third showing that its stock price was "artificially inflated." However, assuming petitioners possessed such information, federal securities laws would have prohibited them from taking advantage of such information by directing the Plan to sell the Fifth Third shares that the Plan already held. *See* Securities Exchange Act of 1934, §§ 10(b), 21D(b), as amended, 15 U.S.C. §§ 78j(b), 78u-4(b); 17 C.F.R. § 240.10b-5-1; *see also* 29 U.S.C. §§ 1144(a), (b)(2), (d) (ERISA preempts

state law, but not any federal law or state securities laws).

ERISA does not require a fiduciary to break the law. *Cf.* Restatement (Second) of Trusts § 166, cmt. a ("The trustee is not under a duty to the beneficiary to do an act which is criminal or tortious."). Thus, ERISA's duty of prudence does not require a plan fiduciary to engage in unlawful insider trading, no matter how beneficial the insider trading might be to the plan or the plan's participants. As the Second Circuit put it, "[t]he prudent man does not commit insider trading." *Rinehart v. Akers*, 722 F.3d 137, 147 (2d Cir. 2013). A robust presumption of prudence "gives fiduciaries a safe harbor from failing to use insider information to divest from employer stock," ensuring that they will not be sued for refusing to break the law. *Quan v. Computer Scis. Corp.*, 623 F.3d 870, 881 (9th Cir. 2010); *see also Kirschbaum*, 526 F.3d at 256 (the prohibition on insider trading "reinforce[s] the conclusion that the *Moench* presumption cannot be lightly overcome").

To be sure, a fiduciary in this position could lawfully cease making *new* investments, *see* 17 C.F.R. § 240.10b-5; *Chiarella v. United States,* 445 U.S. 222, 226-27 (1980), or could disclose the nonpublic information and then divest, *see* U.S. Cert. Br. 12. But these half-measures are unworkable at best and self-defeating at worst, leading to anomalous results that deference to ESOP fiduciaries would avoid.

If a company makes an unexplained decision to bar new investments by its ESOP in its own stock, the market would have ample reason to suspect that something was wrong and to react unfavorably. Such

a reaction would put at risk the considerable number of shares *already* held by the plan.[17] Of course, the severity, timing, and duration of the market's reaction would be uncertain, but any decline in stock price could well exceed the decline that would have occurred if the material nonpublic information had been publicly disclosed. A prudent fiduciary is unlikely to take this very risky approach, and certainly a fiduciary would not be acting imprudently because she chose *not* to make such a high-stakes gamble.

The Government's suggestion of simply disclosing the information is similarly unhelpful. Since the public disclosure of negative information would result in a downward market adjustment, the post-disclosure price of the stock would no longer be "artificially inflated." As a result, any divestment would be made at the non-inflated price, and would not aid participants at all. *See Edgar v. Avaya, Inc.,* 503 F.3d 340, 350 (3d Cir. 2007). More fundamentally, the Government's approach contemplates that a company's decision to establish an ESOP will have far-reaching ripple effects on its corporate disclosures. Congress cannot have intended a law governing employee benefits to "disturb[] the carefully delineated corporate disclosure laws" in this way. *Citigroup*, 662 F.3d at 145 (citation and internal quotation marks omitted).[18]

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[17] In a typical mature plan, the number of shares of employer stock already held by the plan (as a result of investments made over a period of years) vastly exceeds the number of shares currently being acquired under the plan each year.

[18] Respondents have suggested that petitioners could have resolved this quandary by simply resigning. J.A. 88-89 (¶ 197). But they

II. Failure To Allege Facts Satisfying The Applicable Standard Of Review Under ERISA Is Fatal At The Pleading Stage.

For the reasons explained in Part I above, ERISA strictly limits the circumstances in which an ESOP fiduciary's decision to invest in employer securities can be deemed imprudent. The text of the statute, trust law, the purposes of ERISA, and the need to construe the statute in harmony with securities law all compel deferential review when a plaintiff challenges an ESOP fiduciary's decision to adhere to the terms and purpose of the plan by continuing to invest in employer stock. It follows that if a plaintiff cannot plausibly allege facts showing an entitlement to relief under this standard, the complaint must be dismissed. *See Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007). Put simply, if the plaintiff cannot point to the sort of extraordinary circumstances that would render continued investment in employer securities imprudent *in the context of an ESOP*, she has not "show[n] that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2).

Iqbal, like this case, involved a cause of action that accorded built-in deference to the defendant – in that

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do not explain how this would help plan participants: If petitioners did not pass along the material nonpublic information to their successors, the successor fiduciaries would not be in a position to use the information. If petitioners *did* pass along the material nonpublic information to their successors, the successor fiduciaries would be subject to the same securities-law constraints that applied to petitioners before they resigned. *See United States v. O'Hagan*, 521 U.S. 642, 650-59 (1997); *Dirks v. SEC*, 463 U.S. 646, 655 - 64 (1983).

case in the form of qualified immunity. Since entitlement to relief meant overcoming qualified immunity, plaintiffs had to "plead sufficient factual matter" to do just that, *i.e.*, show "a violation of a clearly established right." 556 U.S. at 677; *id.* ("purpose" to discriminate had to be plausibly alleged because that showing is required "[i]n the context of determining whether there is a violation of clearly established right to overcome qualified immunity"). So too here, plaintiffs were required to "plead sufficient factual matter" to show a violation of the duty of prudence as it applies to an ESOP fiduciary.

This result does not change simply because the deferential standard of review of an ESOP fiduciary's investment decisions typically is expressed as a "presumption of prudence." The term "presumption" in this context is simply a shorthand description of the deferential legal standard required by ERISA: an ESOP fiduciary's decision to invest in employer securities is prudent as a matter of law, unless extraordinary circumstances exist that substantially impair the plan's purpose of furthering employee ownership.[19]

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[19] The term "presumption" has been regarded as "the slipperiest member of the family of legal terms"; scholars have identified "no less than eight senses in which the term has been used by the courts." 2 McCormick on Evidence § 342 (7th ed.) (citing Charles V. Laughlin, *In Support of the Thayer Theory of Presumptions*, 52 Mich. L. Rev. 195 (1953)). Thus, as one court of appeals recently noted, use of that term to describe the deferential standard of review due ESOP fiduciaries is arguably "unfortunate." *Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1281 (11th Cir. 2012). Aside from the Sixth Circuit, however, the courts of appeals have understood that the "presumption" label is simply a way of

Notably, this Court has referred to qualified immunity – which imposes a heightened standard that this Court applied at the pleading stage in *Iqbal* – as a "presumption" that is "rebuttable." *Crawford-El v. Britton*, 523 U.S. 574, 587 (1998); *see also Owen v. City of Independence*, 445 U.S. 622, 668 (1980) (Powell, J., dissenting) ("Qualified immunity would provide presumptive protection for discretionary acts."); *Koubriti v. Convertino*, 593 F.3d 459, 466 (6th Cir. 2010) ("government officials generally enjoy a presumption of qualified immunity from civil lawsuits"); *Medina v. Cram*, 252 F.3d 1124, 1129 (10th Cir. 2001) ("The assertion of qualified immunity raises a rebuttable presumption."). Similarly, an opinion for this Court by Justice Brandeis held that "[f]acts relied upon to rebut [a] presumption" had to be "specifically set forth" in the pleadings to avoid dismissal. *Pac. States Box & Basket Co. v. White*, 296 U.S. 176, 185 (1935). And in corporate law, a plaintiff seeking to overcome the business judgment rule's "presumption that directors act . . . in the best interests of the company" must do so through specific allegations at the pleading stage. *In re Tower Air Inc.*, 416 F.3d 229, 238 (3d Cir. 2005); *In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275, 285-86 (Del. Ch. 2003).[20] There is nothing

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expressing the deference accorded to ESOP fiduciaries. As long as this Court clarifies that point, there is little harm in maintaining terminology that, even if imprecise, has been a fixture of ERISA law for nearly twenty years.

[20] *See also Jacobs v. Vrobel*, 724 F.3d 217, 220-21 (D.C. Cir. 2013) (in Westfall Act cases where the Attorney General certifies the employee acted within scope of his employment, plaintiff must allege facts that would overcome this "rebuttable presumption");

talismanic about the label "presumption" that relieves plaintiffs of the need to plead facts showing an entitlement to relief under the applicable legal standard of substantive liability for ESOP fiduciaries.

The court below therefore erred in holding the presumption of prudence irrelevant at the pleading stage. It based its decision on the conclusory statement that a so-called "evidentiary presumption" is "not an additional pleading requirement." *Pfeil*, 671 F.3d at 592; Pet. App. 11-12. To be sure, some presumptions are purely evidentiary in nature; the so-called "bursting bubble" presumption operates only "to shift the burden of producing evidence with regard to the presumed fact," after which it "is spent and disappears." 2 McCormick on Evidence § 344. Other presumptions, however, impose "a heavy burden of persuasion," *id.*, and "the location of the burden of persuasion . . . determine[s] *the burden of making allegations*," Charles V. Laughlin, *In Support of the*

Del Marcelle v. Brown Cnty. Corp., 680 F.3d 887, 914 (7th Cir. 2012) (in a "class-of-one" Equal Protection case, where plaintiff alleges only that he was subject to a "subjective and individualized" decision, "[t]hat sort of accusation would not be enough to show plausibly that plaintiff will be able to rebut the presumption of rationality"); 30 C.J.S. Employer-Employee Relationship § 33 ("An employee hired without an express contract has the burden of pleading and proving an exception to the presumption of at-will employment."); 1 Fed. Proc., Lawyers' Ed. § 1:107 ("The doctrine that a prisoner must introduce more than 'unsubstantiated declarations' to rebut the presumption that he or she retains his or her preincarceration domicile relates to the ultimate burden of proof, but there is a concomitant burden of pleading – the complaint must allege facts sufficient to raise a substantial question about the prisoner's intention to acquire a new domicile.").

Thayer Theory of Presumptions, 52 Mich. L. Rev. 195, 201 (1953) (emphasis added). Moreover, presumptions "are inextricably intertwined with the pertinent substantive law," and therefore "substantive considerations have a considerable impact on the procedural effect desirable for a particular presumption." 2 McCormick on Evidence § 344.

Properly understood, *see supra* Part I, the "presumption of prudence" expresses the substantive standard a plaintiff must meet by pleadings and proof. Far from merely assigning the burden of producing facts at trial, ERISA imposes a substantive hurdle the plaintiff must surmount to establish a breach of the duty of prudence. Any other conclusion would give short shrift to the "substantive considerations" embedded in the statutory scheme. If courts were to give ESOP fiduciaries nothing more than the benefit of a weak evidentiary presumption, that result would disregard the "character and aims" of ESOPs, depart from trust law, and defeat Congress's purposes. In sum, and as every court of appeals to address the question (aside from the Sixth Circuit) has recognized, there is "no reason to allow [a] case to proceed to discovery when, even if the allegations are proven true, [the plaintiff] cannot establish that defendants abused their discretion." *Edgar*, 503 F.3d at 348-49.[21]

The Sixth Circuit also contended that the presumption could not be applied at the pleading stage because, unlike most other circuits, it has "not adopted

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[21] *See also Citigroup*, 662 F.3d at 139-40; *Kopp v. Klein*, 722 F.3d 327, 338-39 (5th Cir. 2013); *White*, 714 F.3d at 990-91; *Lanfear*, 679 F.3d at 1281.

a specific rebuttal standard," and allows plaintiffs, "having had an opportunity to conduct formal discovery, [to] come forward with rebuttal proofs of many kinds." *Pfeil*, 671 F.3d at 595. As explained above, the lower court's refusal to adopt a standard is itself error: ERISA requires plaintiffs to make the difficult showing that continuing to invest in employer securities would substantially defeat the purposes of the ESOP. *Supra* Part I. But even if the Court were to adopt some less specific standard, it is incorrect that flexible standards admitting "proofs of many kinds" cannot apply at the pleading stage. *See, e.g.*, *Matrixx Initiatives v. Siracusano*, 131 S. Ct. 1309, 1322-23 (2011) (conducting a detailed review of pleadings to determine whether a complex set of factual allegations, if true, would satisfy the general "materiality" standard).[22]

III. Respondents Have Not Stated A Claim For Breach Of The Duty Of Prudence.

When measured against the correct legal standard, respondents' pleadings cannot survive a motion to dismiss. The gravamen of their complaint is that the price of Fifth Third stock – like the stock market generally during the financial crisis – declined, and

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[22] The Sixth Circuit also relied on the "plain language" of its earlier opinions saying the presumption could be rebutted "by *showing* that a prudent fiduciary acting under similar circumstances would have made a different investment decision." *Pfeil*, 671 F.3d at 592-93 (emphasis in original) (internal quotation omitted). Although the court appears to have viewed a "showing" as something that cannot occur at the pleading stage, the exact requirement of the Federal Rules is to allege facts "*showing* that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2) (emphasis added).

petitioners knew or should have known that these losses arising from Fifth Third's loan portfolio were on the horizon. J.A. 36-37, 87 (¶¶ 50, 190). In respondents' view, the only prudent course of action for petitioners in this circumstance was to disregard the Plan's express requirement that its ESOP component remain invested "primarily in shares of common stock of Fifth Third Bancorp." J.A. 350-51 (Plan, art. 7.4(a)). At bottom, respondents' theory is that petitioners were "required to depart from the Plan's directives regarding [Fifth Third stock] just because they were aware that the stock price would likely fall." *Lanfear*, 679 F.3d at 1282.

These allegations fall far short of what is necessary to state a claim for breach of the duty of prudence by an ESOP fiduciary. Respondents have alleged no facts that would plausibly show that continued investment would substantially impair the Plan's fundamental purpose, *i.e.*, employee ownership of Fifth Third stock. Their allegations do not show, for example, that employees' interest in building long-term shares in their employer would be thwarted by an impending collapse of the company. To the contrary, Fifth Third's substantial recovery had already begun during the class period. In short, if every one of the facts alleged in the complaint were true, they still could not establish entitlement to relief under the deferential standard of review owed to ESOP fiduciaries.

Participation in an ESOP comes with trade-offs. As Congress recognized, there are important advantages – the opportunity to build a stake in one's employer and share in its long-term success. Tax Reform Act of 1976, § 803. Congress was also well aware of the

disadvantages – exposure to "the risk of large losses" inherent in any undiversified fund. 29 U.S.C. § 1104(a)(1)(C). Fifth Third employees for whom this downside risk was unacceptable had the freedom to transfer all or any part of their investment in the ESOP to another fund that was not part of the ESOP. J.A. 576-77 (Plan, Seventh Amendment art. 7.3). Those who remained invested in the ESOP (and therefore in the company), and those who continued to invest in the ESOP and the company, shared with other stockholders in the losses of the financial crisis; now they are sharing with other stockholders in the gains of Fifth Third's rebound. Throughout, petitioners followed the express terms of the Plan. Absent extraordinary circumstances showing that this course of action had become manifestly inconsistent with the Plan's purpose of building employee ownership – and respondents allege none – petitioners satisfied the duty of prudence. Accordingly, respondents' claim for breach of that duty must be dismissed.

CONCLUSION

The judgment of the court of appeals should be reversed.

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APPENDIX

STATUTORY APPENDIX

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29 U.S.C. § 1104. Fiduciary duties

(a) Prudent man standard of care

(1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and--

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

(2) In the case of an eligible individual account plan (as defined in section 1107(d)(3) of this title), the diversification requirement of paragraph (1)(C) and

the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 1107(d)(4) and (5) of this title).

* * *

29 U.S.C. § 1106. Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect--

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

(2) No fiduciary who has authority or discretion to control or manage the assets of a plan shall permit the plan to hold any employer security or employer

real property if he knows or should know that holding such security or real property violates section 1107(a) of this title.

(b) Transactions between plan and fiduciary

A fiduciary with respect to a plan shall not--

(1) deal with the assets of the plan in his own interest or for his own account,

(2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or

(3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.

* * *

29 U.S.C. § 1107. Limitation with respect to acquisition and holding of employer securities and employer real property by certain plans

(a) Percentage limitation

Except as otherwise provided in this section and section 1114 of this title:

(1) A plan may not acquire or hold--

(A) any employer security which is not a qualifying employer security, or

(B) any employer real property which is not qualifying employer real property.

(2) A plan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of employer securities and employer real property held by the plan exceeds 10 percent of the fair market value of the assets of the plan.

(3)(A) After December 31, 1984, a plan may not hold any qualifying employer securities or qualifying employer real property (or both) to the extent that the aggregate fair market value of such securities and property determined on December 31, 1984, exceeds 10 percent of the greater of--

(i) the fair market value of the assets of the plan, determined on December 31, 1984, or

(ii) the fair market value of the assets of the plan determined on January 1, 1975.

* * *

(b) Exception

(1) Subsection (a) of this section shall not apply to any acquisition or holding of qualifying employer securities or qualifying employer real property by an eligible individual account plan.

* * *

(d) Definitions

For purposes of this section--

(1) The term "employer security" means a security issued by an employer of employees covered by the plan, or by an affiliate of such employer. A contract to which section 1108(b)(5) of this title applies shall not be treated as a security for purposes of this section.

(2) The term "employer real property" means real property (and related personal property) which is leased to an employer of employees covered by the plan, or to an affiliate of such employer. For purposes of determining the time at which a plan acquires employer real property for purposes of this section, such property shall be deemed to be acquired by the plan on the date on which the plan acquires the property or on the date on which the lease to the employer (or affiliate) is entered into, whichever is later.

(3)(A) The term "eligible individual account plan" means an individual account plan which is (i) a profit-sharing, stock bonus, thrift, or savings plan; (ii) an employee stock ownership plan; or (iii) a money purchase plan which was in existence on September 2, 1974, and which on such date invested primarily in qualifying employer securities. Such term excludes an individual retirement account or annuity described in section 408 of Title 26.

(B) Notwithstanding subparagraph (A), a plan shall be treated as an eligible individual account plan with respect to the acquisition or holding of qualifying employer real property or qualifying

employer securities only if such plan explicitly provides for acquisition and holding of qualifying employer securities or qualifying employer real property (as the case may be). In the case of a plan in existence on September 2, 1974, this subparagraph shall not take effect until January 1, 1976.

(C) The term "eligible individual account plan" does not include any individual account plan the benefits of which are taken into account in determining the benefits payable to a participant under any defined benefit plan.

* * *

(5) The term "qualifying employer security" means an employer security which is--

(A) stock,

(B) a marketable obligation (as defined in subsection (e) of this section), or

(C) an interest in a publicly traded partnership (as defined in section 7704(b) of Title 26), but only if such partnership is an existing partnership as defined in section 10211(c)(2)(A) of the Revenue Act of 1987 (Public Law 100-203).

After December 17, 1987, in the case of a plan other than an eligible individual account plan, an employer security described in subparagraph (A) or (C) shall be considered a qualifying employer security only if such employer security satisfies the requirements of subsection (f)(1) of this section.

(6) The term "employee stock ownership plan" means an individual account plan--

(A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified, under section 401 of Title 26, and which is designed to invest primarily in qualifying employer securities, and

(B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.

* * *

29 U.S.C. § 1108. Exemptions from prohibited transactions

* * *

(b) Enumeration of transactions exempted from section 1106 prohibitions

The prohibitions provided in section 1106 of this title shall not apply to any of the following transactions:

* * *

(3) A loan to an employee stock ownership plan (as defined in section 1107(d)(6) of this title), if–

(A) such loan is primarily for the benefit of participants and beneficiaries of the plan, and

(B) such loan is at an interest rate which is not in excess of a reasonable rate.

If the plan gives collateral to a party in interest for such loan, such collateral may consist only of qualifying employer securities (as defined in section 1107(d)(5) of this title).

* * *

(e) Acquisition or sale by plan of qualifying employer securities; acquisition, sale, or lease by plan of qualifying employer real property

Sections 1106 and 1107 of this title shall not apply to the acquisition or sale by a plan of qualifying employer securities (as defined in section 1107(d)(5) of this title) or acquisition, sale or lease by a plan of qualifying employer real property (as defined in section 1107(d)(4) of this title)--

(1) if such acquisition, sale, or lease is for adequate consideration (or in the case of a marketable obligation, at a price not less favorable to the plan than the price determined under section 1107(e)(1) of this title),

(2) if no commission is charged with respect thereto, and

(3) if--

(A) the plan is an eligible individual account plan (as defined in section 1107(d)(3) of this title), or

(B) in the case of an acquisition or lease of qualifying employer real property by a plan which is not an eligible individual account plan, or of an acquisition of qualifying employer

securities by such a plan, the lease or acquisition is not prohibited by section 1107(a) of this title.

* * *

Tax Reform Act of 1976, Pub. L. No. 94-155, § 803

* * *

(h) Intent of Congress Concerning Employee Stock Ownership Plans.— The Congress, in a series of laws (the Regional Rail Reorganization Act of 1973, the Employee Retirement Income Security Act of 1974, the Trade Act of 1974, and the Tax Reduction Act of 1975) and this Act has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans. Because of the special purposes for which employee stock ownership plans are established, it is consistent with the intent of Congress to permit these plans (whether structured as pension, stock bonus, or profit-sharing plans) to distribute income on employer securities currently.

* * *