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

REPLY BRIEF FOR PETITIONERS

James E. Burke
Counsel of Record
Danielle M. D'Addesa
David T. Bules
Joseph M. Callow, Jr.
Keating Muething & Klekamp PLL
One East Fourth St.
Suite 1400
Cincinnati, OH 45202
(513) 579-6400
jburke@kmklaw.com

Robert A. Long, Jr.
John M. Vine
David M. Zionts
Covington & Burling LLP
1201 Pennsylvania Ave NW
Washington, DC 20004
(202) 662-6000

Counsel for Petitioners

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES AND REGULATIONS

OTHER AUTHORITIES

REPLY BRIEF FOR PETITIONERS

Neither respondents nor the Government defend the decision below. The court of appeals held that an ESOP fiduciary's decision to remain invested in company securities is accorded a "presumption of prudence," but declined to apply the presumption at the pleading stage. Respondents and the Government argue instead that ESOP fiduciaries should *never* be accorded a presumption of prudence – a position that has been unanimously rejected by the courts of appeals. To support their argument, respondents and the Government disregard clear statements of congressional intent and insert words into the statute that are not there. The Government asks the Court to jettison the standard applied by the lower courts in favor of a vague, untested, and unworkable "overvaluation" standard. Respondents attempt to redirect the Court's attention even further afield, injecting arguments about ERISA's duty of loyalty that are not properly before the Court and in any event lack merit. The decision of the court of appeals should be reversed.

I. Neither Respondents Nor The Government Defend The Court Of Appeals' Holding That The Presumption Of Prudence Is Inapplicable At The Pleading Stage.

Every court of appeals to have decided the issue agrees that an ESOP fiduciary's decision to adhere to plan terms by continuing to invest in employer securities is presumptively prudent. *See* Pet. Br. 22 (citing cases). The Sixth Circuit has created a circuit

conflict by refusing to apply this presumption at the pleading stage. Pet. App. 11-12; Pet. Br. 49. In the court below, both respondents and the Government argued that the presumption does not apply at the pleading stage. *See* Resp. C.A. Br. 16-25; U.S. C.A. Br. 18-26.

Before this Court, however, neither respondents nor the Government even address, let alone defend, the Sixth Circuit's holding that the presumption of prudence does not apply at the pleading stage. For the reasons set out in petitioners' opening brief, the Sixth Circuit's position is wrong. *See* Pet. Br. 45-50.

Rather than addressing the issue that has divided the circuits, respondents and the Government have chosen to address a different issue. They argue that there should be no presumption of prudence at *any* stage of the case. There is no circuit split on this issue; the position advocated by respondents and the Government has been *unanimously* rejected by no fewer than seven courts of appeals. Pet. Br. 22. Moreover, the Government asked this Court to amend the question presented to include this issue, *see* U.S. Cert. Br. 19, and the Court declined to do so. The Government nevertheless devotes its entire brief to the question. To the extent the Court considers this question, it should reject the Government's position.

II. Offering Employer Stock As An Investment Option Is Presumptively Prudent, Absent Fundamentally Changed Circumstances Making The Investment Inconsistent With The ESOP's Basic Purpose.

The text, structure, and history of ERISA establish that the core purpose of an ESOP is to provide an opportunity to build employee ownership of employer stock. *See* Pet. Br. 25-42. Thus, it is ordinarily prudent for an ESOP fiduciary to do exactly what the plan instructs her to do: allow participants to continue investing in employer stock. A prudent person managing an enterprise with the "character" and "aim" of increasing employees' ownership stake usually will act to further that purpose, even if the stock price is volatile.

But not always. If, due to fundamentally changed circumstances, continued investment in employer securities would no longer further the aim of building long-term employee ownership, it would no longer be prudent to follow the plan's terms. As trust law confirms, prudence may require deviating from the plan's terms, but *only* when adherence to those terms would no longer further the plan's purpose. Pet. Br. 25-30. Aside from the court below, every appellate court to address the question has adopted a comparable standard.

Respondents and the Government, however, view that standard as "extreme." Defying clear expressions of congressional intent, they argue that ESOPs may not be administered for the purpose of building employee stock ownership. They further argue that Congress's decision not to completely

exempt ESOP fiduciaries from the duty of prudence implies that courts must impose a particularly strict standard of prudence. And they ask this Court to replace the sound standard developed by the lower courts with an untested, ill-defined, and unworkable "materially overvalued" standard. These arguments lack merit.

A. The Prudence Standard Takes Account Of An ESOP's "Character And Aims".

1. The Fundamental Purpose Of An ESOP Is To Allow Employees To Acquire An Ownership Stake In Their Employer.

a. Congress defined the duty of prudence in terms of the "character" and "aims" of the "enterprise." 29 U.S.C. § 1104(a)(1)(B). Respondents and the Government contend that Courts must ignore the distinctive "character and aims" of ESOPs because building employee stock ownership is not a legally cognizable plan objective. This novel approach is fundamentally at odds with ERISA. As ERISA's text makes clear, investing in employer securities is exactly what an ESOP is "designed" to do. 29 U.S.C. § 1107(d)(6)(A). Indeed, an ESOP is defined as a "stock bonus plan" – that is, a plan in which the benefits are distributable in *employer stock*. *Id.*; *see also* 26 C.F.R. § 1.401-1(b)(1)(iii) (defining "stock bonus plan"). The core purpose of an ESOP is confirmed by the structure of the statute, which exempts ESOPs from the diversification requirement so that ESOPs can pursue their distinctive aim. 29 U.S.C. § 1104(a)(1)(C), (a)(2). Failure to diversify

"would be perilous if ESOPs were intended to replace traditional pension arrangements, but they are not; they are intended to promote the ownership . . . of firms by their employees." *Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003).

The special purpose of ESOPs is further confirmed by the Tax Reform Act of 1976, which expressly distinguishes "conventional retirement plans" from ESOPs, which are intended to "bring[] about [employee] stock ownership." Pub. L. No. 94-455, § 803(h). The Government attempts to dismiss the Tax Reform Act as a "mere" statement of "congressional intent" concerning certain tax regulations. U.S. Br. 21. Had Congress's concerns been so limited, it could have adopted legislation disapproving those regulations. Instead, Congress enacted a sweeping declaration of policy concerning ESOPs, and stated that it "made clear its interest [in ESOPs]" in ERISA. Tax Reform Act of 1976, § 803(h). In addition, Congress expressly provided that ESOPS, because of their "special purposes," may "distribute [dividends] on employer securities currently." *Id.* A plan that provided only retirement benefits could not make such current distributions.[1]

b. The Government's sole textual basis for ignoring the special character and aims of an ESOP

---

[1] The Government similarly dismisses the relevance of the ERISA Conference Report's statement that ESOPs are "designed to build equity ownership" for employees, H.R. Rep. No. 93-1280, at 313 (1974) (Conf. Rep.). U.S. Br. 22-23. The statement's context hardly undermines its value in showing that Congress viewed building employee ownership as the core purpose of ESOPs.

is the requirement that fiduciaries administer plans for the "exclusive purpose" of "providing benefits to participants." U.S. Br. 19 (quoting 29 U.S.C. § 1104(a)(1)(A)). That provision simply prohibits fiduciaries from pursuing selfish motives in administering a plan. It does not forbid them from pursuing the plan's objectives, as the settlor – and Congress – intended.

The Government reads the "exclusive purpose" provision not just to exclude improper motives, but to require fiduciaries to maximize retirement security to the exclusion of other goals – a perspective that is fundamentally inconsistent with the diversification exemption, and has never been adopted by the courts. *Cf. Loomis v. Exelon Corp.*, 658 F.3d 667, 673 (7th Cir. 2001) (rejecting a "paternalistic" approach to ERISA that would prevent plans from offering "high-risk, and potentially high-return" options). To reach this result, the Government rewrites the statute, inserting the word "*retirement*" before "benefits." U.S. Br. 19 (referring to "ERISA's explicit command to operate plans with the exclusive goal of safeguarding *retirement* benefits" (emphasis added)).[2] This atextual approach ignores the fact that ERISA plans can and do have objectives other than, or in addition to, providing retirement benefits. For example, an ERISA-covered pension plan may provide for death and disability benefits, as well as severance distributions before the employee attains

---

[2] Similarly, respondents suggest that § 1104(a)(1) requires fiduciaries to impose their vision of participants' "best interests." Resp. Br. 41. The term "best interests" does not appear in § 1104.

retirement age – distributions that could not be made if the fiduciary were limited to "safeguarding retirement benefits." *See, e.g.*, 29 U.S.C. § 1055; 26 U.S.C. § 401(k)(2)(B)(i).

To be sure, ESOPs can deliver very substantial retirement benefits. An ESOP provides employees the opportunity to invest in their employer's success, and potentially reap a large return at retirement. Moreover, employees are demonstrably better off in pension plans with ESOP components than without them, since employer contributions to ESOP plans typically are much higher. *See* ESOP Ass'n Br. 24. But an ESOP's primary objective, attributable to Congress's clear policy choice, is to build employee ownership. Nothing in ERISA's general requirement that fiduciaries act to "provid[e] benefits to participants" requires fiduciaries to disregard this core purpose.

c. In support of its view that an ESOP fiduciary may not pursue the goal of employee ownership, the Government points to Congress's efforts to "improve the reliability of ESOPs as retirement vehicles." U.S. Br. 20. As the Government recognizes, however, Congress promoted employees' retirement security by expanding their rights to diversify *out of* ESOPs. *See* Pension Protection Act of 2006 ("PPA"), Pub. L. No. 109-280, § 901; *see also* I.R.S. Notice 2006-107, 2006-2 C.B. 1114 (model notice to employees, warning that their "retirement savings . . . may not be properly diversified" if they make excessive investments in employer stock). Thus, the Government has it backwards: in limiting certain employers' ability to *compel* employees to build ownership through an ESOP, Congress has

recognized that an undiversified ESOP is not, on its own, an optimal retirement vehicle.

Far from supporting respondents and the Government, the PPA reflects Congress's continuing commitment to employee ownership.[3] Faced with post-Enron criticisms of ESOPs, Congress responded by enhancing employee choice – not by restricting ESOPs or imposing untenable duties on fiduciaries. Notably, respondents and their *amici* repeat many of the same policy arguments for limiting employee choice that Congress rejected. *See, e.g.*, Law Professors Br. 14. Consistent with Congress's policy decision to continue encouraging ESOPs while expanding employee choice, participants in plans like Fifth Third's are free to avoid or limit the risks inherent in investment in employer stock.[4]

In amending ERISA to expand employees' diversification rights, Congress was aware that courts were applying a presumption of prudence. *See Retirement Insecurity: 401(k) Crisis at Enron, Hearing Before the S. Comm. on Governmental Affairs*, 107th Cong. 68 (2002) ("Enron Hearing")

---

[3] During the legislative process, the Secretary of Labor recognized that "[b]y statutory design, ESOPs are intended to promote worker ownership of their employer with the goal of aligning worker and employer interests." *Protecting the Pensions of Working Americans: Lessons From the Enron Debacle, Hearing Before the S. Comm. on Health, Ed., Labor, & Pensions*, 107th Cong. 27 (2002) ("Chao Testimony").

[4] Respondents falsely charge that the Plan granted participants the right to divest from employer stock not as "an accident of generosity," but only to comply with the PPA. Resp. Br. 5 n.3. In fact, the Plan granted these rights before Congress required them. J.A. 576.

(testimony of Stephen M. Saxon). Congress's decision to amend certain of ERISA's ESOP provisions without changing the prudence standard indicates agreement with the presumption. *See, e.g.*, *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 414 n.8 (1975) (Congress "plainly ratified" the unanimous rulings of the courts of appeals when it amended Title VII without abrogating those rulings).

In sum, it is quite wrong to say that petitioners, by allowing participants to continue investing in employer stock, have "subordinated" employees' interests to some illegitimate objective. U.S. Br. 8, 20, 21; *see also* Resp. Br. 1, 23, 37. Congress has determined that the opportunity to build ownership of employer stock *is* an employee interest. Recognizing that employees also have a vital interest in retirement security, Congress expanded the rights of participants in many plans to further that interest. It would frustrate these decisions, and do violence to the statutory prudence standard, to ignore ESOPs' unique "character and aims" and treat them as nothing more than conventional retirement plans.

2. A Robust Presumption Gives Full Effect To The Duty Of Prudence.

Respondents and the Government argue that certain provisions of ERISA reflect an intent to subject all fiduciaries to "[t]he same" standard of prudence. U.S. Br. 15. To reach this result, they mistakenly conflate the *existence* of a duty with the *content* of that duty in particular circumstances.

Congress exempted ESOP fiduciaries from the duty of prudence "only to the extent that it requires

diversification," 29 U.S.C. § 1104(a)(2), and further prohibited plans from waiving the duty, *id.* §§ 1104(a)(1)(D), 1110(a). It follows from these provisions that ESOP fiduciaries owe plan participants a duty of prudence. What does *not* follow is the notion that a single, inflexible *standard* applies to all plans. That conclusion rests on faulty logic. It also ignores ERISA's clear textual command that the standard of prudence is *not* always the same, but instead depends on the "character" and "aims" of the plan. That is not "loose and aspirational" language that can be ignored (Resp. Br. 28); it is the context-sensitive standard that Congress adopted. *Cf.* Department of Labor, Employee Benefits Security Admin. Field Assistance Bulletin 2012-01 (Apr. 2, 2012), *available at* http://tinyurl.com/FAB2012-1 (noting that the "special characteristics and aims" of ERISA-covered apprenticeship and training plans allow fiduciaries of such plans to incur expenses that would be impermissible for plans with different aims).[5]

Accounting for the character and aims of an ESOP does not, as respondents and the Government suggest, vitiate the duty of prudence; it simply applies the duty in context, as the statute requires. As applied to ESOP fiduciaries, the duty of prudence serves several meaningful functions. As an initial matter, ESOP fiduciaries have a range of

---

[5] Respondents and the Government have no response to the testimony of Secretary of Labor Shultz that ERISA's prudence standard was written with "built-in flexibility" requiring the court to take into account the "goals of the plan." Pet. Br. 26 (quoting Shultz testimony).

responsibilities unrelated to investment decisions that they must perform prudently. For example, where employer stock is not publicly traded, ESOP fiduciaries must act prudently in setting a "redemption price" for employees leaving the company. *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 732-33 (7th Cir. 2006). More generally, fiduciaries of all plans, including ESOPs, incur administrative expenses and must determine whether a particular "expenditure is a prudent use of plan assets." Department of Labor, Guidance on Settlor v. Plan Expenses (last visited Mar. 10, 2014), http://tinyurl.com/DOLPlanExpense.[6]

An ESOP fiduciary's decision to allow continued investment in employer stock may violate the duty of prudence if, because of fundamentally changed circumstances, adherence to the plan's terms would no longer further the ESOP's special purposes. The existence of dire financial straits is a leading *example* of such a change, because continued investment in a company on the brink of collapse would not meaningfully further the ESOP's goal of building employee ownership of an ongoing enterprise.[7] But other such changes could occur. For

---

[6] *See also* Letter from Elliot I. Daniel, Assoc. Dir. for Regulations and Interpretations, Dep't of Labor, to Kirk F. Maldonado (Mar. 2, 1987), *available at* http://tinyurl.com/DOLMaldonado (prudence of expenses for "[a]nnual valuations of the sponsoring employer's stock held by the Plan").

[7] Petitioners' opening brief clearly stated that impending collapse was an "example" of when a fiduciary could be required to deviate from the plan. Pet. Br. 24. Referring to this (continued…)

instance, if unscrupulous managers took control of a company and began operating it in a fundamentally unlawful manner, building employee ownership of an effectively criminal enterprise could be inconsistent with the ESOP's original purpose. *See In re Enron Corp. Sec., Derivative & "ERISA" Litig.*, 284 F. Supp. 2d 511 (S.D. Tex. 2003) (allegation that Enron was operated as a RICO enterprise). If an ESOP was created with the understanding that employees would be free to divest company stock in a liquid market at any time, prudence might demand that the fiduciary cease offering this option if company stock became thinly traded.[8] Another fundamental change in circumstances might occur if Congress were to impose adverse tax consequences on employees participating in ESOPs.[9]

It is entirely appropriate that such claims meet a high bar, because circumstances that fundamentally undermine an ESOP's basic purpose are unusual. But this standard is not "virtually insurmountable," U.S. Br. 25, and does not mean that there is no meaningful duty of prudence. It means only that the

---

standard as limited to dire financial circumstances, Resp. Br. 12 & n.6, misstates petitioners' position.

[8] In this circumstance, a fiduciary might conclude that unless she deviated from the terms of the plan, the plan would violate the requirement of the Section 404(c) safe harbor regulation that employer securities held by the plan be "publicly traded." *See* 29 C.F.R. § 2550.404c-1(d)(2)(ii)(E)(4)(iii), (iv).

[9] *See* Enron Hearing 124 (response of Karen Ferguson to questions for the record) (proposing that tax deferral of ESOP investments be limited to amount "that experts deem to be a prudent allocation").

content of that duty is appropriately tailored to the unique context of an ESOP. This result gives full effect to Congress's decision not to exempt ESOP fiduciaries from the duty of prudence. Unlike respondents' and the Government's position, it also gives full effect to the language of the statutory prudence standard and Congress's objective of encouraging employee stock ownership.[10]

B. The Government's Novel "Materially Overvalued" Standard Is Unworkable And Unfaithful To ERISA.

The Government rejects as "extreme" (U.S. Br. 27) the prudence standard applied by most courts and urges the Court to replace it with a novel standard that has never been accepted or applied by *any* court. The Government's proposed standard would subject fiduciaries to liability for continuing to offer investment in employer stock that is "materially overvalued." U.S. Br. 17. This standard treats an ESOP's investment in employer securities like any other plan's investment in any other fund, disregarding the plan's unique purpose.

---

[10] In discussing trust law, respondents and the Government again confuse the existence of the duty of prudence with the content of that duty in particular circumstances. They argue that a trust law-derived standard is inconsistent with ERISA's departure from the trust law rule that settlors can waive the duty of prudence. U.S. Br. 24. Although ERISA's duty of prudence cannot be waived, courts must still determine when the statutory duty of prudence requires a fiduciary to depart from otherwise valid plan terms. Trust law's deviation doctrine provides guidance for that determination. *See* Pet. Br. 30-34.

An ESOP could not achieve its long-term goal of building employee ownership if its fiduciaries were forced to start and stop investments based on serial guesses about the stock's "true value" (U.S. Br. 26, 29). On any given day, a company may possess a mix of positive and negative information that could materially affect its stock price. Even if nonpublic information could lawfully drive a fiduciary's day-to-day investment decisions, the goal of an ESOP necessitates a longer view. The Government's proposed standard would also place ESOP fiduciaries in an untenable position, subject to being sued whether or not they deviated from the terms of the plan. *See Lanfear v. Home Depot, Inc.*, 679 F.3d 1267, 1279 (11th Cir. 2012) (absent a strong presumption of prudence, ESOP fiduciaries would be forced to "choose between the devil and the deep blue sea"). Under the Government's theory, moreover, fiduciaries would face still more lawsuits for permitting participants to *sell* company stock when the market has *undervalued* it, since stock can be "undervalued" just as readily as it can be "overvalued."

In addition to being unmoored from statutory text, the Government's standard is unworkable. A plaintiff might offer at least four reasons to conclude that employer stock was "materially overvalued": (1) the stock price fell; (2) there was negative, publicly available information about the company; (3) there was negative, *nonpublic* information about the company; and (4) the company made material misrepresentations to the market. The problems with each of these theories demonstrate why the Government's standard should be rejected.

1. Stock Drop. The Government recognizes that a drop in employer stock price, even a precipitous one, does not mean that the stock was "materially overvalued." U.S. Br. 26-27. But this concession will provide cold comfort to fiduciaries attempting to determine, *ex ante*, whether the price of the employer stock is close enough to its "true" value. Any competent plaintiffs' lawyer, with the benefit of hindsight, will be able to craft a complaint that meets the Government's proposed standard. Once the stock price has fallen, it will not take much imagination to allege reasons for the drop that fiduciaries "knew or should have known." U.S. Br. 27. As a practical matter, the Government's standard will expose fiduciaries to costly litigation whenever there is a substantial stock drop.

2. Public Information. Respondents acknowledge that "the relevant information" showing that Fifth Third stock was overvalued was "public in some sense." Resp. Br. 38. When the market sets a price based on all relevant information, fiduciaries (and courts) cannot be expected to determine if there is some alternate, "true" value of the stock. *Cf.* 29 U.S.C. §§ 1002(18), 1108(e) (defining "adequate consideration" for the sale of a qualifying employer security as "the price of the security prevailing on a national securities exchange"). Whether markets are perfectly efficient, *see* Resp. Br. 24-25, is beside the point. If informed, independent investors are buying at the market price, prudence cannot require a fiduciary to "outsmart the rest of the market." *White v. Marshall & Ilsley Corp.*, 714 F.3d 980, 992 (7th Cir. 2013). The Government offers no support for respondents' theory that fiduciaries must determine

whether a fully-informed market is "overvaluing" employer stock.

3. Material Nonpublic Information. The market could conceivably "overvalue" (or "undervalue") a company's stock because it lacks material nonpublic information. This is respondents' fallback theory of why Fifth Third stock was overvalued, premised on the mere possibility that "discovery might bring to light" such information. Resp. Br. 39. *But see Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 559-60 (2007).

The Government and respondents agree that divesting employer stock based on material nonpublic information is illegal. U.S. Br. 28; Resp. Br. 43. The Government also agrees that ceasing investment could cause the market to overreact, harming participants. U.S. Br. 28-29. Its response is to suggest that courts "take[] into account" this and other complications "in computing any damages," U.S. Br. 29 – hardly a tidy solution. The Government's preferred course of action is for a fiduciary simply to disclose the nonpublic information. But recognizing the oddity of ERISA driving corporate disclosure requirements, the Government declares that fiduciaries need not disclose information "sooner than when federal securities laws would require." U.S. Br. 29. Thus, the Government's apparent view is that fiduciaries *may* purchase "overvalued" employer stock (and allow sales of "undervalued" stock) during certain intervals of the SEC calendar, but may not prudently do so at other times. When a proposed legal standard requires this many caveats and contortions, that is a good sign it is unworkable.

4. Material Misrepresentations. The core of the Government's theory appears to be that fiduciaries are liable for investing in securities that are "materially overpriced as a result of market misrepresentations." U.S. Br. 22. In its view, respondents stated a claim by alleging that petitioners knew or should have known "that Fifth Third stock was not worth what the Plan was paying for it," because "the company's subprime mortgage lending practice was misleadingly or insufficiently disclosed." U.S. Br. 33. Notably, that is not respondents' view of their own case. Respondents believe that the information establishing that Fifth Third was a poor investment was "public," at least "in some sense." Resp. Br. 38. In any event, the Government's proposal of a quasi-securities fraud cause of action under the guise of ERISA is misguided.

As this Court has held, the "threshold" for fiduciary liability is that the defendant "was acting as a fiduciary." *Pegram v. Herdrich*, 530 U.S. 211, 226 (2000). Consequently, there is no ERISA cause of action for misrepresentations made to the market generally, and not directed at plan participants. *See Varity Corp. v. Howe*, 516 U.S. 489, 505 (1996); *infra* pp. 21-22. The Government's proposed approach would circumvent that rule, creating an indirect avenue to a result the Court has previously rejected.

That result would also enable an end-run around Congress's carefully calibrated rules for securities litigation. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67 (enacting heightened pleading standards, automatic stay of discovery, and other protections). This case demonstrates the

significant anomalies created by the Government's approach. The Government believes respondents have stated a claim that Fifth Third stock was overpriced because of misrepresentations to the market, but respondents do not even attempt to state a claim for securities fraud. Even more to the point, a court has *dismissed* securities fraud claims based on the same factual allegations. *Local 295/Local 851 IBT Emp'r Grp. Pension Trust & Welfare Fund v. Fifth Third Bancorp.*, 731 F. Supp. 2d 689, 726-28 (S.D. Ohio 2010).[11] Nowhere does the Government explain how – or why – courts should determine that a security is "materially overvalued" because of an alleged misrepresentation *that does not give rise to a securities fraud claim*.

To be clear, petitioners do not take the position that employees who choose to invest in an ESOP in reliance on material misrepresentations are unprotected. Like any other investor who is misled, they would generally have access to a securities law remedy. *See, e.g.*, *Kurzweil v. Philip Morris Cos.*, 2001 WL 25700, at *3-4 (S.D.N.Y. Jan. 10, 2001) (Mukasey, J.) (permitting ESOP participants to recover from a securities settlement fund); *see also* Department of Labor, Class Exemption for the Release of Claims and Extensions of Credit in

[11] In dismissing these claims, the court pointed out that "much of the information that Plaintiffs claim was concealed," including the composition of Fifth Third's loan portfolio, "was actually reported." *Id.* at 727. This dismissal is far more relevant than Fifth Third's settlement, without any admission of wrongdoing, of SEC claims that it should have recorded certain losses in the third, rather than fourth, quarter of 2008. U.S. Br. 6 n.2.

Connection With Litigation, 68 Fed. Reg. 75,632, 75,637 (Dec. 31, 2003) ("The plan, and by extension, the participants and beneficiaries of the plan, are entitled to the same recovery as other shareholders in the securities fraud settlement."). Particularly in light of these protections, there is no need to construe ERISA as an alternative avenue for securities litigation.

* * *

In short, holding ESOP fiduciaries liable for investing in employer securities that are "materially overvalued" – in the hindsight of a court – is not viable. It would be a recipe for litigation and a strong deterrent to forming ESOPs. *Cf. Conkright v. Frommert*, 559 U.S. 506, 517 (2010). Not only would this result thwart Congress's objective of promoting ESOPs, but the disappearance of ESOPs could lead to a reduction in employers' willingness "to make generous contributions to workers' 401(k) plans." Chao Testimony 30; *see* ESOP Ass'n Br. 24. Adopting a vague "material overvaluation" standard would not supply employees with needed protection; it would just lead employers to circumscribe employee choice in investment options and curtail pension benefits.

One final anomaly in the Government's position merits attention. Both the Government and respondents insist that all the practical concerns petitioners have raised could be avoided if companies would simply delegate fiduciary responsibilities to "a non-insider, such as an outside financial institution." U.S. Br. 30; *see* Resp. Br. 43-44. It is far from clear that this is so. As the Government (but not respondents) recognizes, simply appointing an

independent fiduciary is not enough, because the appointing fiduciary (an employee of the company) has "a fiduciary duty to keep the [independent fiduciary] informed of any pertinent information." U.S. Br. 31. The Government's solution is to designate as the *appointing* fiduciary someone who is "not likely to know material inside information." U.S. Br. 31. But even if a sufficiently low-level employee could be identified, putting a multi-million dollar ESOP in the hands of such an employee might itself violate ERISA. *See* 29 C.F.R. § 2509.75-8(D-4). Moreover, even if an employer could overcome all these problems and successfully insulate an independent fiduciary from inside information, employees would be no better off. A truly insulated fiduciary could not know that the company possessed material nonpublic information or that its public statements were false or incomplete, and so would have no reason to conclude that employer stock was "materially overvalued" (or "undervalued"). That fiduciary would therefore do exactly what petitioners did here (at additional cost to the plan): adhere to the ESOP's terms.

III. Respondents' Arguments Based On The Duty Of Loyalty Lack Merit.

Respondents (but not the Government) seek to divert the Court's attention from the duty of prudence by injecting arguments about the duty of loyalty into this case. Notwithstanding a lengthy footnote that protests too much (Resp. Br. 15-16 n.8), respondents have not made these arguments until now. *See* Resp. C.A. Br. This Court need not and should not expand the question presented to consider arguments that were not presented to the courts

below and have not been accepted by a single court of appeals.

In any event, respondents' claims of disloyalty are fundamentally flawed. Their basic contention is that petitioners have "elevate[d] irrelevant employer interests over the beneficiary interests that ERISA brings to the fore." Resp. Br. 37. As explained above, this position flatly disregards Congress's longstanding policy, expressed in ERISA and elsewhere, that an opportunity to build ownership of employer stock *is* in employees' interest. *Supra* pp. 5-7. Respondents and their *amici* are free to disagree with that policy. But they cannot fairly argue that petitioners were "disloyal" to respondents by continuing to offer them a congressionally-approved benefit.

In addition to this overarching theory of disloyalty for adhering to the purpose of the ESOP, respondents offer three other theories: that petitioners were disloyal for (1) making misrepresentations; (2) failing to provide investment advice; and (3) having a potential conflict of interest. These arguments are not properly presented, and lack merit in any event.

1. Misrepresentations. Quoting *Varity*, respondents argue that "lying is inconsistent with the duty of loyalty," and claim to have "identifie[d] more than a dozen false, misleading, and incomplete statements that petitioners made to respondent[s]." Resp. Br. 22. Petitioners do not dispute that ERISA prohibits fiduciaries from lying *to plan participants* when acting *in a fiduciary capacity*. But respondents point only to alleged misrepresentations made not "to respondents" but to the market generally. *See* J.A.

57-79. Any such misrepresentations were not made in a fiduciary capacity, and thus do not give rise to an ERISA violation. *See Pegram*, 530 U.S. at 226; *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 256-57 (5th Cir. 2008) (alleged misrepresentations in SEC filings were not made in fiduciary capacity).

The court of appeals agreed with respondents' distinct argument that petitioners are liable for misrepresentations in SEC filings because they were incorporated by reference in the Summary Plan Description. Pet. App. 22-23. Petitioners disagree with that holding, but this Court did not grant certiorari on the question. Respondents' *Varity* claim for misrepresentations made in a fiduciary capacity to plan participants therefore will remain in the case regardless of what the Court decides on the question on which it granted review.

2. Investment Advice. ERISA establishes a comprehensive disclosure regime requiring plan administrators to furnish participants with specified information about the plan. *See Curtiss-Wright Corp. v. Schoonejongen,* 514 U.S. 73, 83 (1995) (citing 29 U.S.C. §§ 1021-31). Congress recently considered the specific question of disclosures by plans holding publicly traded employer stock, and required notice of diversification rights and the importance of diversifying. PPA § 507(a), § 901; IRS Notice 2006-107 (model notice, "The Importance of Diversifying Your Retirement Savings"). Moreover, Congress relaxed certain ERISA prohibitions to allow greater *access* to investment advice. In implementing this provision, the Department of Labor emphasized that it imposes no *obligation* on plan fiduciaries to provide such advice. PPA § 601; 29 C.F.R.

§ 2550.408g-1(a)(2); *see also* 29 C.F.R. § 2509.96-1 n.1 (qualification for 404(c) safe harbor does not require "investment advice" for participants).

Respondents do not allege that petitioners have violated any aspect of ERISA's disclosure requirements, including the PPA's required diversification notice. Instead, they contend that by failing to "disseminate[] [negative] information to the beneficiaries" – information that they concede was "public" – respondents failed to act as a "loyal investment manager." Resp. Br. 38. In light of ERISA's detailed disclosure provisions, and the principle that fiduciaries are not required to provide investment advice, courts have refused to "create a rule that converts fiduciaries into investment advisors." *Lanfear*, 679 F.3d at 1285; *see also White*, 714 F.3d at 994 ("ERISA does not require fiduciaries of an [ESOP] to act as personal investment advisers to plan participants, nor could they do so."); *In re Citigroup ERISA Litig.*, 662 F.3d 128, 143 (2d Cir. 2011); *Edgar v. Avaya, Inc.,* 503 F.3d 340, 349-350 (3d Cir. 2007). Respondents' proposal to read a sweeping expansion of ERISA's disclosure obligations into the duty of loyalty lacks merit.

3. Potential Conflict. Respondents argue that petitioners decided to adhere to the terms of the Plan *because of* self-interested motives. Resp. Br. 22-23. But that is not what the complaint alleges. Respondents alleged only a *potential* conflict of interest based on the fact that plan fiduciaries received some stock-based compensation. J.A. 89-92. "Under [respondents'] reasoning, almost no corporate manager could ever serve as a fiduciary of his company's Plan. There simply is no evidence that

Congress intended such a severe interpretation of the duty of loyalty." *Citigroup*, 662 F.3d at 145-46; *see also DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 421 & n.6 (4th Cir. 2007). To the contrary, it is clear that this was not Congress's intent. *See* 29 U.S.C. § 1108(c)(3) (providing that corporate officers may serve as fiduciaries); *cf. Metro. Life Ins. Co. v. Glenn*, 554 U.S. 105, 115-16 (2008) (conflicted fiduciaries still entitled to deference).

If respondents' position became the law, it would force massive changes to ERISA plans. This Court has rightly avoided such results. *Glenn*, 554 U.S. at 116 (refusing to adopt an approach to conflicted fiduciaries that would "bring about near universal review by judges *de novo*"). Although respondents assert that it is "now commonplace" for "large corporations" to enlist independent fiduciaries, all they cite is press articles about four plans. Resp. Br. 43 n.27. The experience of one of those plans – the W.R. Grace Plan – demonstrates that outsourcing fiduciary responsibilities is not the panacea respondents claim. *See* Pet. Br. 40 (noting that the W.R. Grace fiduciaries have been sued *both* for selling and for failing to sell employer stock).

Lacking any basis to allege that petitioners acted for purposes of self-enrichment, respondents suggest that petitioners' conduct was so unreasonable that it can be explained only by "the effects of conflicting interests on human action." Resp. Br. 24. But that argument works only if petitioners' behavior was unreasonable. Taking into account the character and aims of the plan they were administering – as ERISA requires – petitioners' decision to continue offering employer stock as an investment option was

entirely reasonable. Thus, respondents' effort to avoid the presumption of prudence through the duty of loyalty is circular and cannot succeed. Absent a violation of the duty of prudence, any basis for an inference of disloyalty disappears.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

James E. Burke
Counsel of Record
Danielle M. D'Addesa
David T. Bules
Joseph M. Callow, Jr.
Keating Muething &
Klekamp PLL
One East Fourth St.
Suite 1400
Cincinnati, OH 45202
(513) 579-6400

Robert A. Long, Jr.
John M. Vine
David M. Zionts
Covington & Burling LLP
1201 Pennsylvania Ave, NW
Washington, DC 20004
(202) 662-6000

Counsel for Petitioners

March 2014