No. 11-1531

IN THE

Supreme Court of the United States

STEPHEN GRAY, *et al.*,
Petitioners,

v.

CITIGROUP INC., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF IN OPPOSITION

JOHN H. LONGWELL
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
2001 K Street, N.W.
Washington, D.C. 20006
(202) 223-7300

LEWIS R. CLAYTON
Counsel of Record
BRAD S. KARP
SUSANNA M. BUERGEL
NEIL R. LIEBERMAN
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, N.Y. 10019
(212) 373-3000
lclayton@paulweiss.com

Counsel for Respondents

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

1. Whether the Second Circuit correctly joined every other court of appeals that has addressed the issue by holding that a fiduciary's compliance with a plan requirement to offer employer stock as an investment option in an employee stock ownership plan ("ESOP") or eligible individual account plan ("EIAP") is subject to judicial review for abuse of discretion under Section 404(a)(1)(B) of the Employee Retirement Income Security Act, 29 U.S.C. § 1104(a)(1)(B).

2. Whether the Second Circuit correctly held that, in order to state a claim under that standard, a plaintiff must plausibly allege that the plan fiduciary's conduct amounted to an abuse of discretion.

RULE 29.6 STATEMENT

Citigroup Inc. is publicly traded and has no parent company. No publicly held corporation owns 10% or more of its stock.

The parent company of Citibank, N.A., is Citicorp Holdings Inc., which in turn is a wholly owned subsidiary of Citigroup Inc.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

CASES **Page(s)**

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

STATUTES

OTHER AUTHORITIES

IN THE

Supreme Court of the United States

No. 11-1531

STEPHEN GRAY, *et al.*,
Petitioners,
v.
CITIGROUP INC., *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF IN OPPOSITION

Respondents Citigroup Inc., Citibank, N.A., the Plans Administration Committee, the Plans Investment Committee, Charles O. Prince, Robert E. Rubin, Jorge Bermudez, Michael Burke, Steve Calabro, Larry Jones, Faith Massingale, Thomas Santangelo, Alisa Seminara, Richard Tazik, James Costabile, Robert Grogan, Robin Leopold, Glenn Regan, Christine Simpson, Timothy Tucker, Leo Viola, Donald Young, Marcia Young, and John Does 1-20 respectfully submit that the petition for a writ of certiorari should be denied.

SUMMARY

Congress designed ERISA to encourage the formation of employee benefit plans that specifically permit investment in the securities of the participants' employer. In this case, the Second Circuit addressed the standard of review applicable to claims that a fiduciary of such a plan breached ERISA's "duty of prudence" by permitting investment in company stock during a period of price decline. The Second Circuit held that, where plan documents require fiduciaries to offer company stock as an investment option, allowing participants in an ESOP[1] to invest in company stock is presumptively prudent under ERISA and subject to review only for abuse of discretion.

That holding was consistent with the approach stated nearly two decades ago by the Third Circuit in *Moench* v. *Robertson*, 62 F.3d 553 (3d Cir. 1995), and adopted by every court of appeals that has addressed the issue since. In particular, the Second Circuit agreed with its sister circuits (six to date) that the abuse of discretion standard, rooted in ERISA's text and the common law of trusts, is consistent with Congress's goal of promoting ESOPs. Judicial deference to ERISA fiduciaries is a well-established means of promoting "efficiency, predictability, and uniformity" in plan administration. *Conkright* v. *Frommert*, 130 S. Ct. 1640, 1649 (2010). As the

---

[1] Although the common stock component of one of the plans at issue was not designated as an employee stock ownership plan ("ESOP"), it is an eligible individual account plan ("EIAP") and therefore subject to the same fiduciary duty rules as an ESOP. *See* Pet. App. 11a. This brief adopts the convention of Petitioners and the Second Circuit of referring to ESOPs and EIAPs interchangeably. *Id.*; Pet. 3 n.1.

courts of appeals have recognized, a more intrusive standard of review would be contrary to the statutory text, raise the cost of administering ESOPs, and likely deter companies from sponsoring such plans.

The courts of appeals have also recognized that ERISA prudence claims against ESOP fiduciaries typically seek redress for fiduciaries' failure to deviate from plan mandates that they are otherwise bound to follow. Moreover, such claims often attack fiduciaries for failure to act on material, non-public information—conduct otherwise fatally inconsistent with the securities laws. Thus, the courts have adopted a deferential standard of review to avoid placing fiduciaries in an untenable position. Of course, nothing in the rule adopted by the various courts of appeals precludes participants from bringing valid claims *under the securities laws* based on their holdings of company stock, and such claims have been brought in this instance.

Given the uniform and well-reasoned authority in the courts of appeals on the applicable standard of review, the petition should be denied. Petitioners' argument that a decision of the Sixth Circuit creates a split of authority is contradicted by the decision itself, in which the panel—as it was bound to do—adhered to Sixth Circuit precedent adopting the abuse of discretion standard. Far from revealing a split, the case law shows remarkable and lasting consensus among the courts of appeals on the standard of review. If Congress believes that the courts of appeals have erred, then it "is free to change [an] interpretation of its legislation," *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720, 736 (1977), something it has declined to do in the 17 years since *Moench.*

The Second Circuit's procedural ruling that the abuse of discretion standard applies at the pleading stage is unworthy of this Court's review. It is plainly correct. When and if a conflict develops regarding the *Moench* presumption, the Court can address the procedural issue as well.

STATEMENT

1. Petitioners seek to represent a putative class of "participants and beneficiaries" in the Citigroup 401(k) Plan and the Citibuilder 401(k) Plan for Puerto Rico (together, "the Plans") during a class period of January 1, 2007 to January 15, 2008. Pet. App. 3a, 5a. Respondents are Citigroup Inc. and Citibank, N.A.—the sponsors of the Plans—as well as certain officers, directors, and members of the committees charged with administering the Plans and making investment options available to participants. *Id.* at 3a.

During the class period, participants in the Plans could choose from approximately 20 to 40 different investment options, including a variety of index funds and actively managed mutual funds. *Id.* at 4a. Among these investment options was the Citigroup Common Stock Fund (the "Stock Fund"). *Id.* The Stock Fund invested in Citigroup stock, and it was authorized "to hold cash and short-term investments" solely in order to avoid market-disrupting transactions and to pay benefits. *Id.*

The Plans clearly and explicitly required fiduciaries to offer and "permanently" maintain the Stock Fund as an investment option. Section 7.01 of the Citigroup 401(k) Plan provided, for example, that although the Investment Committee was authorized to eliminate any other investment option, "the Citigroup Common Stock Fund shall be permanently maintained as an Investment Fund under the Plan." *Id.* Participants, however, had no obligation to invest in the Stock Fund and had sole discretion over their investment choices within the Plans. *Id.*

2. The Stock Fund qualified as an ESOP under ERISA. *Id.* at 84a. Such plans, with their unique purposes, enjoy a distinct legal status. Congress has described "employee stock ownership plans as a bold and innovative method . . . of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees." 26 U.S.C. § 4975 (notes). And it has warned against "rulings which treat employee stock ownership plans as conventional retirement plans." *Id.* Many statutes contain special rules to promote ESOPs, and ERISA is one such law.[2]

Section 404(a)(1) of ERISA, 29 U.S.C. § 1104(a)(1), which defines the standard of conduct for plan fiduciaries under the Act, provides, among other things, that fiduciaries must act "with the care, skill, prudence, and diligence under the circumstances" of a "prudent man," § 1104(a)(1)(B), and "in accordance with the documents and instruments governing the plan" consistent with ERISA, § 1104(a)(1)(D). Except with respect to ESOPs, fiduciaries must also "diversify[] the investments of the plan so as to minimize the risk of large losses, unless under the circum-

[2] *See also, e.g.*, 26 U.S.C. § 46 (corporate tax credit); *id.* § 409 (tax deductions and exemptions); *id.* § 409 (tax exemptions and interest exclusions); *id.* § 404 (expanding availability to S corporations); *id.* § 4975 (f)(7) (permitting S corporations to use distributions on stock held by ESOPs to repay loans used by ESOPs to acquire stock for employees).

stances it is clearly prudent not to do so." § 1104(a)(1)(C).

In the case of ESOPs, Section 404(a)(2) provides that for ESOP fiduciaries "the diversification requirement . . . and the prudence requirement (only to the extent it requires diversification) . . . [are] not violated by acquisition or holding of qualifying . . . employer securities. . . ." *Id*. § 1104(a)(2). ERISA therefore contemplates that fiduciaries will follow the governing documents establishing ESOPs, which call for investment in employer stock. The Act also protects fiduciaries from claims of breach of fiduciary duty for failure to diversify an ESOP.

Section 404(a)(2) arguably bars all claims against ESOP fiduciaries based on allegations that it was imprudent to maintain company stock as an investment option, because such claims are merely "camouflaged diversification claim[s]." *Lanfear* v. *Home Depot, Inc.*, 679 F.3d 1267, 1275 (11th Cir. 2012) (describing district court holding, which it rejected); *see also Wright* v. *Or. Metallurgical Corp.*, 360 F.3d 1090, 1097 (9th Cir. 2004) ("If there is no duty to diversify ESOP plan assets under the statute, it logically follows that there can be no claim for breach of fiduciary duty . . . arising out of allowing the plan to become heavily weighted in company stock." (internal quotation marks omitted)). The courts of appeals, however, have adopted an interpretation that does not foreclose such claims entirely.

3. "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)

(footnote omitted). The district court and the Second Circuit both applied this principle in dismissing Petitioners' fiduciary duty claims.

a. Petitioners sought recovery for losses sustained by the Stock Fund over the class period, when market turmoil stemming from the credit crisis caused Citigroup's share price to decline 52 percent, from $55.70 to $26.94. Pet. App. 5a. After reciting many of the unprecedented and unanticipated events in the financial markets during the crisis, Petitioners alleged that Respondents breached their fiduciary duty of prudence "by refusing to divest the Plans of Citigroup stock even though Citigroup's 'perilous operations in the subprime securities market' made it an imprudent investment option." Pet. App. 5a-6a. Petitioners argued that "a prudent fiduciary would have foreseen a drop in the price of Citigroup stock and either suspended participants' ability to invest in the Stock Fund or diversified the Fund so that it held less Citigroup stock." *Id.*[3]

The district court dismissed the complaint for failure to state a claim. First, the district court held that because the Plans required fiduciaries to offer the Stock Fund as an investment option, the defendants

---

[3] In addition to their "prudence" claim, Petitioners brought several other claims, none of which is before the Court, including the allegation that defendants violated their duty of loyalty by failing to provide truthful and complete information relating to the value of Citigroup stock. Pet. App. 22a. Although the petition for certiorari argues that the Second Circuit erred by affirming the dismissal of this "communications" claim, Pet. 28-29, the issue is not raised in the questions presented and therefore is not before the Court. *See* S. Ct. Rule 14.1(a); *Izumi Seimitsu Kogyo Kabushiki Kaisha* v. *U.S. Phillips Corp.*, 510 U.S. 27, 34 (1993).

were not acting as fiduciaries and thus could not be held liable for breach of fiduciary duty for complying with that directive. *See* 29 U.S.C. § 1002(21)(A) (defining "fiduciary" as one who exercises "discretionary authority" over plan management). Losses caused by a decline of the company's stock price, the court held, were "a natural result of the plan's design" and not the fault of fiduciaries "who were adhering to the mandatory terms of a plan that was designed not to guarantee income but to encourage stock ownership." Pet. App. 102a-103a. Second, the district court concluded that even if any defendant had discretion to eliminate Citigroup stock from among the investment options in the Plans, the complaint failed to allege facts sufficient to state a plausible claim of abuse of discretion. Pet. App. 109a.

b. The Second Circuit affirmed. Unlike the district court, it declined to hold that ESOP fiduciaries were immune from liability where the plan mandated investment in company stock, noting that ERISA requires fiduciaries to comply with plan documents "only to the extent they are consistent with ERISA." *Id.* at 17a. But the court nonetheless found that the plan language mandating the inclusion of employer stock as an investment option, together with the unique characteristics of ESOPs and Congress's desire to promote them, warranted a deferential standard of review for claims of breach of fiduciary duty in the ESOP context.

The court cited the Third Circuit's analysis in *Moench* and decisions of the Fifth, Sixth, and Ninth Circuits, all of which adopted "a presumption of compliance with ERISA when an ESOP fiduciary invests assets in the employer's stock." *Id.* at 12a. After noting that "[n]o court of appeals has rejected the presumption of prudence," the Second Circuit "join[ed] [its] sister circuits in adopting the *Moench* presumption . . . because, as those courts have recognized, it provides the best accommodation between the competing ERISA values of protecting retirement assets and encouraging investment in employer stock." *Id.* at 14a. Accordingly, the court of appeals held that an ESOP fiduciary could be liable under ERISA for breach of fiduciary duty only where the fiduciary "abuses his discretion in continuing to offer plan participants the opportunity to invest in employer stock." *Id.* at 14a-15a.

The Second Circuit held that deference would avoid rendering ESOP fiduciaries "equally vulnerable to suit if they adhered to the plan's terms and the company stock decreased in value, or for deviating from the plan by selling if the stock later increased in value." *Id.* at 15a (citing *Quan* v. *Computer Sci. Corp.*, 623 F.3d 870 (9th Cir. 2010)); *see also Kirschbaum* v. *Reliant Energy, Inc.*, 526 F.3d 243 (5th Cir. 2008); *Lanfear*, 679 F.3d at 1279 ("Closer judicial scrutiny would force ESOP fiduciaries to choose between the devil and the deep blue sea."). Imposing that risk, the court held, would fail to "account for Congress's concern that employees' ability to invest in employer stock would be endangered were courts to apply ERISA to ESOPs and EIAPs in the same way they apply the statute to other retirement plans." Pet. App. 15a. (citing Tax Reform Act of 1976 § 803(h), 26 U.S.C. § 4975 (notes)).

The court of appeals also addressed how a plaintiff could allege and prove an abuse of discretion. Following *Moench*, and based on the common law of trusts, the Second Circuit held that "fiduciaries should override plan terms requiring or strongly favoring investment in employer stock only when 'owing to circumstances not known to the [plan] settlor and not anticipated by him,' maintaining the investment in company stock 'would defeat or substantially impair the accomplishment of the purposes of the [Plan].' " *Id.* at 18a (quoting *Moench*, 62 F.3d at 571 (quoting Restatement (Second) of Trusts § 227 cmt. g)).[4] "[We] cannot imagine that an ESOP or EIAP settlor, mindful of the long-term horizon of retirement savings, would intend that fiduciaries divest from employer stock at the sign of any impending price decline." *Id.* Instead, the court stated that fiduciaries could have a duty to override ESOP terms only where there was no "room for reasonable fiduciaries to disagree as to whether they are bound to divest from company stock." *Id.* (quoting *Quan*, 623 F.3d at 882).

Applying this standard, the Second Circuit held that Petitioners failed to state a claim. Mere allegations that the stock was "inflated" during the class period due to ill-advised investments in the subprime market, the court held, were insufficient to show that the company was in a "dire situation," much less that any fiduciary knew as much. *Id.* at 20a. And the court held that Petitioners' allegation that plan fiduciaries "knew or should have known about Citigroup's massive subprime exposure" was no more than a "bald assertion" insufficient to support a claim under *Bell Atlantic Corp.* v. *Twombly*, 550 U.S. 544, 555 (2007). *Id.* Nor did Petitioners allege facts to support the claim that an adequate investigation would have revealed impending subprime losses or their magnitude. *Id.* at 21a. Finally, the Second Circuit held

[4] Although the Third Circuit in *Moench* cited comment g of Section 227 of the Restatement (Second), the quoted phrases appear in comment q.

that even knowledge by plan fiduciaries that Citigroup would lose tens of billions of dollars would not necessarily have compelled them to conclude that the financial situation of the company, with a market capitalization of almost $200 billion, was so bleak that the only reasonable course was to divest the Plans of company stock. *Id.* To the contrary, in December 2007 and January 2008, near the end of the class period, Citigroup raised more than $30 billion from sophisticated investors who remained confident in the company's future. Citigroup Annual Report (Form 10-K), at 76 (Feb. 22, 2008).

Judge Straub dissented. He would not have applied an abuse of discretion standard of review to Petitioners' claims. *Id.* at 33a.

REASONS FOR DENYING THE PETITION

I. THE CIRCUITS HAVE UNIFORMLY INTERPRETED ERISA'S DUTY OF PRUDENCE IN THE ESOP CONTEXT.

A. The courts of appeals agree on the legal standard governing claims of breach of the ERISA duty of prudence against ESOP fiduciaries. Where a fiduciary has a duty under the plan to offer company stock, the courts of appeals have uniformly held that compliance with that obligation is presumptively prudent absent circumstances showing that any reasonable fiduciary would be bound to deviate from the plan. Pet. App. 18a.

By adopting this interpretation of the duty of prudence in the ESOP context, the Second Circuit joined all other circuits that had addressed the issue (the Third, Fifth, Sixth, Seventh, and Ninth). Pet. App.

13a-14a.[5] Since the Second Circuit's decision, the Eleventh Circuit has also followed suit. *Lanfear*, 679 F.3d 1267. No court of appeals has taken a different approach.

This uniform approach is the product of careful reasoning by the lower courts and years of judicial experience. Seventeen years ago, the Third Circuit adopted the abuse of discretion standard in *Moench* as a "limited" alternative to a complete bar to claims against ESOP fiduciaries for breach of the duty of prudence. 62 F.3d at 556. The court considered evidence of Congress's intent to encourage ESOPs, including the unique status of ESOPs under ERISA and the dual role of ESOPs as a mechanism of corporate finance and a vehicle for retirement savings. *Id*. at 571. Following this Court's example in *Firestone Tire & Rubber Co.* v. *Bruch*, 489 U.S. 101 (1989), in which the Court found deferential review of discretionary benefits decisions warranted by analogy to trust law, the *Moench* court based its abuse of discretion standard upon the common law of trusts. *Id.* at 566. It reasoned that in a case "in which the fiduciary is not absolutely required to invest in employer securities but is more than simply permitted to make such investments, . . . fiduciaries should not be immune from judicial inquiry, as a directed trustee essentially is, but also should not be subject to . . . strict judicial scrutiny. . . ." 62 F.3d at 571; *see also Edgar* v. *Avaya*, 503 F.3d 340, 347 (3d Cir. 2007) (applying *Moench* to EIAPs).

[5] Although the Second Circuit did not cite a decision by the Seventh Circuit, that court applied the *Moench* standard in *Pugh* v. *Tribune Co.*, 521 F.3d 686, 701-02 (7th Cir. 2009).

Later that year, the Sixth Circuit recognized that "in drafting ERISA, Congress intended to encourage employees' ownership of their employer company," and that "claims that a fiduciary breached his ERISA duties by failing to diversify an ESOP" were in "conflict" with this goal. *Kuper* v. *Iovenko*, 66 F.3d 1447, 1458 (6th Cir. 1995). The Sixth Circuit therefore "adopt[ed] the Third Circuit's holding that a proper balance between the purpose of ERISA and the nature of ESOPs requires that we review an ESOP fiduciary's decision to invest in employer securities for an abuse of discretion." *Id*. at 1459; *see also Pfeil* v. *State St. Bank & Trust Co.*, 671 F.3d 585, 591-92 (6th Cir. 2012).

More recently, courts of appeals have elaborated on the *Moench* rationale and reaffirmed the soundness of its approach. The Fifth Circuit has held that the duty of prudence is a "flexible standard" that must be evaluated in light of the circumstances, including the "long-term horizon of retirement investing" and the "favored status Congress has granted to employee stock investments in their own companies." *Kirschbaum*, 526 F.3d at 253-54 (citation omitted). Adopting *Moench*, the court also reasoned that "a fiduciary cannot be placed in the untenable position of having to predict the company's stock performance" and risk being "sued for not selling if he adhered to the plan, but also sued for deviating from the plan if the stock rebounded." *Id.* at 256. Moreover, the Fifth Circuit stated, "in some cases, requiring a fiduciary to override the terms of a company stock purchase plan could suggest the necessity of trading on insider information," which is "prohibited by the securities laws." *Id.*

The Ninth Circuit echoed these concerns when it adopted the *Moench* standard of review. *Quan*, 623 F.3d at 881 ("Fiduciaries are not expected to predict the future of the company stock's performance. . . ."). At the same time, the court emphasized that "the presumption does not entirely insulate a fiduciary . . . because it may be rebutted by a showing that the fiduciary abused its discretion. . . ." *Id.* at 882. But "if there is room for reasonable fiduciaries to disagree as to whether they are bound to divest from company stock, the abuse of discretion standard protects a fiduciary's choice not to divest." *Id.*

The Second Circuit and the Eleventh Circuit have now also endorsed the approach of these courts of appeals. Both courts did so in thorough opinions that independently examined the rationale for the abuse of discretion standard and found it persuasive. Thus, every court of appeals that has decided the issue has agreed on the proper interpretation of ERISA's duty of prudence in the ESOP context.[6]

B. Petitioners' purported split of authority rests on the Sixth Circuit's recent decision in *Pfeil*, in which the court permitted a claim by participants in a Gen-

---

[6] Neither the Fourth nor the D.C. Circuit has ruled on the *Moench* standard. Petitioners' argument to the contrary (Pet. 17-18) mischaracterizes the decisions of those courts. In *Fink* v. *National Savings & Trust Co.*, 772 F.2d 951 (D.C. Cir. 1995), the D.C. Circuit merely recited the statutory duty of prudence when analyzing the timeliness of the plaintiff's claim. *See id.* at 955-58. And in *DeFelice* v. *U.S. Airways, Inc.*, 497 F.3d 410 (4th Cir. 2007), the Fourth Circuit expressly declined to address the applicability of a deferential standard of review, finding it could affirm the judgment for the defendants without deciding that issue. *Id.* at 419 n.4. No court has adopted Petitioners' interpretation of either case.

eral Motors ESOP to proceed past a motion to dismiss. That case provides no warrant for review.

In *Pfeil*, plaintiffs alleged that an independent ESOP fiduciary, State Street Bank and Trust, "breached its fiduciary duty by continuing to allow participants to invest in GM common stock, even though reliable public information indicated that GM was headed for bankruptcy." 671 F.3d at 588. Although the district court held that the plaintiffs had adequately pleaded a breach of fiduciary duty, it dismissed the claim on the ground that participants' control over the assets in their accounts broke the chain of causation. *Id.*

The Sixth Circuit reversed, holding that the plaintiffs had sufficiently alleged causation. *Id.* at 597.[7] In the course of its opinion, the Sixth Circuit reaffirmed its adherence to the abuse of discretion standard of review. Citing its own prior decision and the decisions of three other courts of appeals, the court held that "[a] fiduciary's decision to remain invested in employer securities is presumed to be reasonable." *Id*. at 591-92. The court even dubbed this approach "the *Kuper* presumption" after its own precedent. *Id*. at 592.

All but ignoring *Pfeil*'s adherence to the abuse of discretion standard, Petitioners draw from the court's analysis two purported conflicts, one illusory and one unworthy of the Court's review.

---

[7] This holding is the subject of a petition for certiorari currently pending before the Court. *See* Petition for Writ of Certiorari, *State St. Bank & Trust Co.* v. *Pfeil*, No. 12-256 (U.S. filed Aug. 24, 2012). The petition does not contend that any other aspect of the Sixth Circuit's decision creates a conflict of authority.

1. Petitioners contend that the Sixth Circuit applies a less deferential substantive legal standard than other courts. Pet. 15-18. But *Pfeil* did not hold that the Sixth Circuit would find an ESOP fiduciary in breach of the duty of prudence for allowing investment in company stock under anything less than extraordinary circumstances. Rather, the court found that the complaint was sufficient to overcome the presumption of prudence where the plaintiffs alleged that (1) the fiduciary, State Street, had "failed to follow the terms of the plans themselves," which—unlike in this case—"required State Street to divest the plans' holdings in company stock if 'there [were] a serious question concerning [GM's] short-term viability as a going concern without resort to bankruptcy proceedings' "; and (2) GM had announced during the class period "that its auditors had 'substantial doubt' regarding the company's 'ability to continue as a going concern.' " 671 F.3d at 589. Addressing these allegations, the Sixth Circuit found that the plaintiffs had "plausibly alleged that General Motors was on the brink of bankruptcy, under circumstances that would more than satisfy the 'dire situation' standard. . . ." *Id*. at 596. The issue whether an ESOP fiduciary could be liable under ERISA for failing to require divestiture in circumstances other than a dire situation was not presented.

In another recent Sixth Circuit case citing *Moench* and *Kuper*, the terms of the ESOP at issue did not place fiduciaries in the otherwise "untenable position" justifying deferential judicial review of decisions to allow beneficiaries to invest in company stock. *See Dudenhoefer* v. *Fifth Third Bancorp*, No. 11-3012, 2012 WL 3826969 (6th Cir. Sept. 5, 2012). In that case, "the Plan Document [did] not mandate that the

Fifth Third Stock Fund invest solely in Fifth Third Stock and [did] not limit the ability of the Plan fiduciaries to remove the Fifth Third Stock Fund or divest assets invested in the Fifth Third Stock Fund. . . ." *Id*. at *1. Thus, the fiduciaries did not face any conflict between their obligations to offer company stock under the plan and to protect the value of plan assets.

Neither the Sixth Circuit nor any other court has held that there are substantive differences among the circuits in an ESOP fiduciary's duty of prudence. To the contrary, the Sixth Circuit follows the uniform rule, first stated in *Moench*, 62 F.3d at 571, that there is no breach of fiduciary duty unless a reasonable fiduciary would be bound to countermand plan terms and block investment in company stock in order to effectuate the purposes of the plan. In *Kuper*, the court paraphrased *Moench* that "the plaintiff must show that the ERISA fiduciary could not have reasonably believed that the Plan's drafters would have intended under the circumstances that he continue" to invest in employer securities. 66 F.3d at 1459. And the court rejected plaintiffs' claim in light of "evidence indicating that a reasonable fiduciary would have continued to hold [employer] stock during the period at issue in this case." *Id.* at 1460. This standard is entirely consistent with the approach of the other courts of appeals.

Far from rejecting *Moench*, the Sixth Circuit has explained that it simply applies the abuse of discretion standard in a more "flexibl[e]" manner, *Pfeil*, 671 F.3d at 594-95, than the more "specific rebuttal standard[s]" articulated by other circuits, *Dudenhoefer*, 2012 WL 3826969, at *5. But variation in the particular verbal formulations courts have used to articulate the abuse of discretion standard does not amount to a split of authority warranting this Court's review. Each of the courts of appeals has recognized that the statutory duty of prudence "is a flexible standard, and [that] a fiduciary's conduct must be evaluated in light of the character and aims of the particular type of plan." *Kirschbaum*, 526 F.3d at 254 (internal quotation marks omitted). That courts have used different words in applying this highly fact-sensitive standard to describe the showings that plaintiffs have made or failed to make does not amount to a substantive conflict among the courts' approaches. Indeed, Petitioners make no attempt to demonstrate—nor could they—that the result in this case or any other case would have been different under the abuse of discretion standard in the Sixth Circuit or any other circuit.[8]

2. The panel in *Pfeil* asserted that "the presumption of reasonableness adopted in *Kuper* . . . does not apply at the motion to dismiss stage." 671 F.3d at 592; *see also Dudenhoefer*, 2012 WL 3826969, at *5. On this point the court disagreed with the Second Circuit and other courts of appeals, but that disagreement, in itself, does not warrant the Court's review. The procedural question whether the abuse of discretion standard applies at the pleading stage is secondary to the substantive *Moench* issue. If a conflict were ever to develop warranting the Court's review of

[8] Petitioners' claim that the Eleventh Circuit has "acknowledged a conflict," Pet. 18, is similarly unfounded. The footnote in *Lanfear* that Petitioners quote referred to the Sixth Circuit's procedural assertion that the *Moench* presumption is inapplicable on a motion to dismiss, not the substantive standard of review. *See* 679 F.3d at 1281 n.16.

the substantive issue, the Court could address the subsidiary procedural question at that time.

Moreover, the Second Circuit's rule is plainly correct. The abuse of discretion standard is not an evidentiary rule defining the quantum of proof plaintiffs must present, but instead defines "an element of a claim that the fiduciary's decision was imprudent." *Lanfear*, 679 F.3d at 1281. Thus, as the Second Circuit held, "[w]here plaintiffs do not allege facts sufficient to establish that a plan fiduciary has abused his discretion, there is no reason not to grant a motion to dismiss." Pet. App. 17a; *see also Ashcroft* v. *Iqbal*, 556 U.S. 662, 678 (2009) (holding that complaint must "plead[] factual content that allows the court to draw the reasonable inference that defendant is liable" under the applicable standard of review). "Quite simply, if a plaintiff does not plead all of the essential elements of his or her legal claim, a district court is required to dismiss the complaint. . . . [A] duty of prudence claim that is on its face inadequate as a matter of law obviates the need for discovery." *Edgar*, 503 F.3d at 349 & n.14.

II. PETITIONERS' CLAIMS OF ERROR ARE UNFOUNDED.

Petitioners ultimately ask this Court to review what they contend is an erroneous interpretation of ERISA's "prudent man" standard by all seven courts of appeals that have considered the issue. Petitioners' arguments—which have been repeatedly rejected by the lower courts—do not cast any doubt on the courts of appeals' interpretation, nor provide any reason to grant review.

A. The Abuse of Discretion Standard Is an Appropriate Interpretation of the Duty of Prudence in the ESOP Context.

Petitioners' principal attack on the abuse of discretion standard is that it is a judicial "exception" to ERISA's prudence requirement that "substantially alter[s]" an otherwise "unqualified" statutory standard of fiduciary duty. Pet. 20-21. This argument rests on the false premise that the duty of prudence is a fixed, bright-line standard of conduct. To the contrary, as the statute provides and the courts have long recognized, the duty of prudence derives its substance from context. The *Moench* rule is an interpretation—rooted in the text of the statute—of the duty of prudence in the ESOP context, not a departure from an "unqualified" statutory standard. And for the reasons given by the courts of appeals, it is an appropriate interpretation.

1. The duty of prudence is not self-defining. ERISA requires a plan fiduciary to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in 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). By its terms, this provision requires courts to assess the reasonableness of a fiduciary's conduct "under the circumstances" and in light of the particular goals of the plan at issue. Congress "expect[ed] 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." H.R. Conf. Rep. No. 93-1280, at 295, 302

(1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5083; *see also Firestone*, 489 U.S. at 110.

Thus the issue in every ERISA prudence case is how a prudent fiduciary would act "under the circumstances," taking into account the "aims" of the plan. 29 U.S.C. § 1104(a)(1)(B). Because ESOPs present different circumstances and have different "aims" from traditional retirement plans—aims that Congress has repeatedly encouraged—courts must interpret the duty of prudence as it applies specifically in the ESOP context. The *Moench* rule is the result now prevailing in every court of appeals that has undertaken that task. For the reasons explained in that case and by each court of appeals that has adopted its reasoning, including the Second Circuit, it provides an appropriate standard of judicial review in light of congressional intent and the special circumstances surrounding ESOP plans.

Far from being—as Petitioners contend—an arbitrary outgrowth of a judicial "adventure," Pet. 27, the abuse of discretion standard is the product of well-settled rules of construction in the ERISA context. By codifying a "prudent man" standard of care, Congress delegated to the courts the role of developing "a 'federal common law of rights and obligations under ERISA-regulated plans.'" *Firestone*, 489 U.S. at 110 (quoting *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 56 (1987)); *see also Franchise Tax Bd.* v. *Constr. Laborers Vacation Trust*, 463 U.S. 1, 24, n.26 (1983) ("'[A] body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans.'" (quoting 120 Cong. Rec. 29942 (1974) (remarks of Sen. Javits))).

This Court has held that courts fulfilling that role should "take account of competing congressional purposes. . . ." *Varity Corp.* v. *Howe*, 516 U.S. 489, 497 (1996). The lower courts identified a conflict between ERISA's fiduciary requirements and the goal of promoting ESOPs, observing that "when the plaintiff claims that an ESOP fiduciary violated its ERISA duties by continuing to invest in employer securities, the conflict becomes particularly stark." *Moench*, 62 F.3d at 569; *see also Lanfear*, 679 F.3d at 1278 ("The goals of ERISA and the ESOP plans it permits conflict to some extent."); Pet. App. 12a ("The Act does not . . . explain when, if ever, plan language requiring investment in employer stock might become inconsistent with the statute's fiduciary obligations. . . ."); *Quan*, 623 F.3d at 879 ("[T]he duty of prudence may be in 'tension' with Congress's expressed preference for plan investment in the employer's stock.") (citation omitted); *Kirschbaum*, 526 F.3d at 253 ("Far from being clear-cut, this claim requires a balance to be struck among competing congressional purposes."); *Kuper*, 66 F.3d at 1458.[9]

Faced with this conflict, the courts of appeals resolved it in the manner this Court has directed—by

[9] Petitioners' argument that there are "no competing obligations imposed on ERISA fiduciaries" in the ESOP context, Pet. 26, contradicts the conclusion of every court that has identified and examined the conflict. To be sure, there would be no conflict if the law permitted fiduciaries to ignore ESOP requirements as freely as Petitioners suggest. But that is not the law. *See* 29 U.S.C. § 1104(a)(1)(D). Petitioners also brush aside the clear congressional policy in favor of ESOPs with the assertion, unsupported by any authority, that it is "doubtful that encouraging employer stock ownership plans is central to the ERISA scheme." Pet. 24. But this *ipse dixit* is insufficient to overcome the voluminous evidence and authority to the contrary.

drawing upon the common law of trusts. *See Firestone*, 489 U.S. at 110. The Third Circuit in *Moench* sought an analogy in trust law for cases in which a fiduciary is "not absolutely required" to make a particular investment "but is more than simply permitted to do so." *Moench*, 62 F.3d at 571 (citing Restatement (Third) of Trusts § 228 cmts. e, f); *see also Edgar*, 503 F.3d at 346-47 (describing "intermediate" standard). Thus, the Third Circuit derived the standard for finding an abuse of discretion from the trust law doctrine permitting fiduciaries to deviate from plan terms when required to effectuate the settlor's intent. *Id.* at 571 (citing Restatement (Second) of Trusts); *see also* Pet. App. 18a.[10] The other courts of appeals have endorsed the Third Circuit's reliance on these principles of trust law in support of the abuse of discretion standard. *Lanfear*, 679 F.3d at 1280-81 ("So, in ERISA cases, we are guided by the principles of trust law." (internal quotations omitted)); *Quan*, 623 F.3d at 881 ("The [*Moench*] presumption is consistent with the statutory language and the trust principles by which ERISA is interpreted. . . ."). This process of interpretation, grounded in this Court's precedent and supported by extensive and thoughtful analysis, is hardly the judicial frolic that Petitioners portray.

[10] Petitioners argue, in a footnote, that the " 'unforeseeable by the settlor' qualification is unjustifiable" because settlor intent cannot justify conduct by a fiduciary that is imprudent under ERISA. Pet. 28 n.4. But the Second Circuit did not hold that settlor intent permits otherwise imprudent conduct; rather, the court held that in the ESOP context, an investment in company stock will only be deemed imprudent under ERISA when the settlor's intent that the plan would hold employer stock can no longer reasonably be effectuated. *See* Pet. App. 18a; *Moench*, 62 F.3d at 571 ("[T]here may come a time when such investments no longer serve the purpose of the trust, or the settlor's intent.")

The abuse of discretion standard has governed ERISA prudence claims against ESOP fiduciaries for nearly two decades in the Third Circuit, and has garnered uniform acceptance in six other courts of appeals. Congress, meanwhile, has not acted to change the standard though it is free to do so. These circumstances are a strong indication that the courts of appeals are correct in their approach. *Illinois Brick Co.* v. *Illinois*, 431 U.S. 720, 736 (1977) ("[C]onsiderations of stare decisis weigh heavily in the area of statutory construction, where Congress is free to change this Court's interpretation of its legislation.").

2. What Petitioners present as the requirements of an "unqualified" duty of prudence are merely their own views of what would have been prudent in this case. They cite no authority, even outside the ESOP context, holding that a fiduciary who believes that a stock is "overvalued" and "bound to fall dramatically" has a duty "to take steps to protect" beneficiaries. Pet. 23. They cite no case to support their assertions that "the prudent fiduciary would at least cease investing in the employer's stock" and possibly "divest at least some of the stock." *Id.* at 24. Certainly the statute does not lay out these requirements. The litany of purportedly prudent actions that Petitioners cites is nothing more than their own competing interpretation of what would be prudent under the circumstances, which—when the circumstances involve an ESOP mandate to offer employer stock—the courts of appeals have rejected.

Petitioners' only textual argument is based on the statute's definition of the duty of diversification in the ESOP context. According to Petitioners, by eliminating the duty to diversify in Section 404(a)(2), Congress resolved all "tension" between its desire to encourage ESOPs and the prudence requirement, such that "further weakening" of the duty of prudence would be inconsistent with the "plain statutory text." *Id.* at 25. This argument attempts to make a silk purse out of a sow's ear. Congress's elimination of the diversification requirement in the ESOP context provides support for the *Moench* rule, not ammunition against it.

Section 404(a)(2) exempts ESOP fiduciaries from claims based on a failure to diversify through "acquisition or holding" of employer securities. 29 U.S.C. § 1104(a)(2). Some courts have viewed this as a *complete bar* to prudence claims against ESOP fiduciaries based on investment in company stock. *See, e.g.*, *Smith* v. *Delta Air Lines, Inc.*, 422 F. Supp. 2d 1310, 1329-30 (N.D. Ga. 2006). Although the courts of appeals have rejected that reading, they cite Section 404(a)(2) as providing a textual basis for their approach to review of claims against ESOP fiduciaries for offering company stock. *E.g.*, *Moench*, 62 F.3d at 570 ("[B]y subjecting an ERISA fiduciary's decision to invest in employer stock to strict judicial scrutiny, we essentially would render meaningless the ERISA provision excepting ESOPs from the duty to diversify."); *Kirschbaum*, 526 F.3d at 254 (subjecting ESOP fiduciaries to *de novo* review "would eviscerate the statutory preference for ESOPs"); *Kuper*, 66 F.3d at 1458-59. Petitioners' novel reading, by contrast, unreasonably infers a legislative intent to throw open the door to such claims from a provision *narrowing* the duty of prudence in the ESOP context. That cannot be what Congress intended.

B. Petitioners' Alternative Approach Is Inconsistent with ERISA and Unworkable.

Although Petitioners criticize the uniform approach of the courts of appeals, they offer no rational alternative. The abuse of discretion standard ensures that ESOP fiduciaries are not liable for permitting investment in company stock except in extraordinary circumstances. This is consistent with ERISA's modified duty of prudence in the ESOP context and Congress's goal of encouraging ESOPs. Petitioners ignore this statutory text and legislative purpose, and instead would require ESOP fiduciaries to be "virtual guarantors of the financial success of the . . . plan." *Moench*, 62 F.3d at 570 (citation omitted). That is not a workable approach.

According to Petitioners, an ESOP fiduciary who becomes aware of information suggesting that employer stock is "substantially overvalued" must "take steps to protect" participants. Pet. 22. Such "steps" could include: "cease investing in employer stock until the undisclosed facts making the stock overvalued were eliminated or reflected the stock's price," or "divest at least some of the stock," or "disclose th[e] facts to the beneficiaries so that they may protect their own interests." *Id.* at 23. Petitioners cite no authority, in the ESOP context or otherwise, in support of these "steps," and there are good reasons why courts have rejected them.

First, trading on material non-public information, or disclosing such information for trading purposes, is prohibited under the securities laws. *E.g.*, *United States* v. *Gansman*, 657 F.3d 85, 92 (2d Cir. 2011). Petitioners nowhere explain how ERISA could plausibly be read to create any exception to this rule. *See*

Quan, 623 F.3d at 883 n.8 ("[F]iduciaries are under no obligation to violate securities laws in order to satisfy their ERISA duties."); *Kirschbaum*, 526 F.3d at 256 ("Fiduciaries may not trade on material information to which the general shareholding public has been denied access."); *Edgar*, 503 F.3d at 350 ("[H]ad defendants decided to divest the Plans of Avaya stock . . . based on information that was not publicly available, they would have faced potential liability under the securities laws for insider trading."); *see also Lanfear*, 679 F.3d at 1282 ("Just as plan participants have no right to insist that fiduciaries be corporate insiders, they have no right to insist that the fiduciaries who are corporate insiders use inside information to the advantage of the participants.").

Second, requiring ESOP fiduciaries to time the market would subject them to liability for inaccurate predictions about the market impact of company information. *See Lanfear*, 679 F.3d at 1282 ("Market timing is not how prudent pension fund investing usually works."). The threat of liability is acute in the ESOP context, where plans encourage or require fiduciaries to offer company stock, because ERISA subjects fiduciaries to strict liability for failing to follow plan requirements. *Quan*, 623 F.3d at 881 ("[W]ithout the *Moench* presumption, a fiduciary could be sued for not selling if he adhered to the plan and the company stock dropped, but also sued for deviating from the plan and selling if the stock rebounded." (quoting *Kirschbaum*, 526 F.3d at 256)); *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. . . ."); *Moench*, 62 F.3d at 572

("[I]f the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer's securities, it may face liability for that caution, particularly if the employer's securities thrive."); *accord Kuper*, 66 F.3d at 1459. Although Petitioners play down this concern, Pet. 31, it is not merely theoretical. In litigation over the W.R. Grace & Co. 401(k) Plan, for example, ESOP fiduciaries faced claims by groups of participants asserting "diametrically opposed" theories of liability—one based on allowing continued investment in company stock, and one alleging imprudent divestiture. *Evans* v. *Akers*, 534 F.3d 65, 68 (1st Cir. 2008).

Petitioners take a one-dimensional view of a multifaceted problem. They portray any limits on judicial review as contrary to ERISA's purpose, and play down competing concerns. *E.g.*, Pet. 24 ("[I]t is doubtful that encouraging employee stock ownership plans is central to the ERISA scheme."). This approach is contrary to this Court's ERISA jurisprudence, which holds that "ERISA represents a careful balancing between ensuring fair and prompt enforcement of rights under a plan and encouragement of the creation of such plans." *Conkright*, 130 S. Ct. at 1649 (internal citations and quotation marks omitted). Indeed, that balancing has led this Court, in the interests of "efficiency, predictability, and uniformity," to require deference to plan fiduciaries in similar contexts. *Id*. (describing *Firestone* deference as "permitting an employer to grant primary interpretive authority over an ERISA plan to the plan administrator").

Petitioners' exclusive focus on legal redress for ESOP beneficiaries also ignores the broader scheme of federal protection for securities investors. Where significant stock declines are the result of misconduct, purchasers and sellers of stock have a variety of remedies under the securities laws. As in the case below, the allegations in an ERISA "stock drop" case mirror those in contemporaneous securities class actions, in which many plan beneficiaries are likely to be class members. *See, e.g.*, *In re Citigroup Inc. Securities Litig.*, 753 F. Supp. 2d 206 (S.D.N.Y. 2010). A deferential standard of review under ERISA, therefore, does not unduly limit protections for ESOP participants.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

LEWIS R. CLAYTON
Counsel of Record
BRAD S. KARP
SUSANNA M. BUERGEL
NEIL R. LIEBERMAN
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
1285 Avenue of the Americas
New York, N.Y. 10019
(212) 373-3000
lclayton@paulweiss.com

JOHN H. LONGWELL
PAUL, WEISS, RIFKIND,
WHARTON & GARRISON LLP
2001 K Street, N.W.
Washington, D.C. 20006
(202) 223-7300

Counsel for Respondents

September 12, 2012