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Prudent Investing

by John M. Vine, Esq.[*]

INTRODUCTION

Some believe that ERISA [1] requires the fiduciaries of employee benefit plans to make "prudent" investments or to offer participants a "prudent" menu of investment options. While these beliefs are understandable, they are mistaken. ERISA requires fiduciaries to discharge their duties with "care, skill, prudence, and diligence," but it does not require employee benefit plans or their fiduciaries to make "prudent" investments or to offer participants a "prudent" menu of investment options.

Although no sensible person would talk about a "careful" stock, a "skillful" bond, or a "diligent" parcel of real estate, people who should know better often say that ERISA requires "prudent" investments. This is not a question of semantics. The difference between prudent investing and prudent investments is substantial, and the consequences of confusing the two could be profound.

Confusing prudent investing and prudent investments could undermine Congress's effort to achieve important legislative objectives. In enacting ERISA, Congress made plan fiduciaries primarily responsible for plan administration and plan investments in order to ensure that such responsibilities were assigned to "those whose experience is daily and continual" and not to "judges whose exposure is episodic and occasional." [2] In recognition of the diversity, dynamism and complexity of employee benefit plans, Congress also included in ERISA a flexible standard of prudence that was designed to give fiduciaries the latitude they need to resolve plan administration and investment issues reasonably and appropriately.

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TAX MANAGEMENT INC.

If the prudence standard applied to a plan's investments, rather than to investing by the plan's fiduciaries, the courts would be required to bear responsibilities that Congress assigned to plan fiduciaries. Following this path would require the courts to make decisions they are not well equipped to make, would diffuse responsibilities that Congress assigned to plan fiduciaries, and would impair the ability of fiduciaries to manage employee benefit plans coherently, consistently and authoritatively.

Consider the case of ''Flip'' Coinflipper, a hypothetical investment manager who makes investment decisions by flipping a coin. ''Heads, I buy; tails, I sell'' is Flip's *mantra*.[3] Flip's business card bears the slogan ''I am bound to get it right some of the time.'' He does. In fact, as luck would have it, in 2009, his first year in business as an investment manager for ERISA plans, every one of Flip's investments was sound and highly profitable, and Flip's investment portfolios outperformed all of the relevant indices and all of the investment portfolios managed by his peers.

If the duty of prudence requires a plan's *fiduciaries* to be prudent, there is a cause of action against Flip under ERISA.[4] To be sure, as Flip did not cause the plans to incur any losses in 2009, there would be no grounds under ERISA for suing Flip for a monetary award. Nevertheless, if — as appears to have been the case — Flip did not discharge his duties with any care, skill, prudence or diligence whatever, he violated the duty of prudence, and ERISA authorizes an action against him for equitable relief, such as removal.[5]

By contrast, if the duty of prudence were interpreted to require the plan's *investments* to be prudent, it should not matter how the fiduciary selected the investments, and there would be no cause of action against Flip. A more detailed explanation follows.

PENSION PLANS

ERISA's fiduciary responsibility provisions apply to most private-sector employee pension and welfare plans.[6] ERISA divides pension plans into two categories: defined benefit plans and individual account plans. Under a defined benefit plan, a participant's benefit typically is a monthly retirement annuity, payable at retirement age and calculated on the basis of the participant's years of service and, in many cases, the participant's compensation as well. Under a defined benefit plan, investment risk is borne primarily by the sponsoring employer. All other things being equal, if the plan's investments do not perform as well as anticipated, the employer must increase its contributions to the plan. In general, a participant in an ongoing defined benefit plan is not exposed to the risk of investment losses by the plan, and is not entitled to benefit from any favorable investment experience that the plan might enjoy.[7]

Under an individual account plan, each participant's benefit is based on the participant's account balance. A participant's account balance is increased by the contributions and forfeitures that are allocated to the account and decreased by withdrawals, distributions, loans, transfers, and the participant's share of plan administration expenses. The participant's account balance also is adjusted, upward or downward, to reflect the investment experience of the assets that are allocated to the participant's account.[8]

The benefits provided by individual account plans thus depend to a large extent on the plan's investment experience.[9] Participants in individual account plans stand to gain if the plan's investment experience is positive, and stand to lose if the plan's investment experience is negative.

The majority of private-sector retirement plans are participant-directed individual account plans.[10] A typical participant-directed individual account plan offers a menu of investment options and allows each participant to allocate his or her account balance among the options on the plan's menu. The participant's account balance is adjusted periodically (under many plans, daily) to reflect the investment experience of the investment options that the participant has chosen.[11]

ERISA's FIDUCIARY STANDARDS

ERISA's provisions governing the management and administration of employee benefit plans focus on the conduct of plan fiduciaries. A person is treated as a ''fiduciary'' under ERISA to the extent that the person exercises any authority or control respecting the management of the plan's assets.[12]

ERISA requires a plan to have ''one or more named fiduciaries'' with ''authority to control and manage the operation and administration of the plan.'' ERISA defines a ''named fiduciary'' as a fiduciary who is named in the plan instrument or who is identified as a fiduciary pursuant to a procedure specified by the plan, and allows a plan to authorize named fiduciaries to exercise certain powers, including the power to appoint investment managers, to allocate and delegate fiduciary responsibilities, to appoint the plan's trustee, to give directions to the plan's trustee, and to review benefit claims appeals. In addition, only a named fiduciary or a fiduciary designated by a named fiduciary may engage an adviser on behalf of the plan.[13]

ERISA's standards of conduct apply to all aspects of a fiduciary's duties as a plan fiduciary.[14] ERISA requires a fiduciary to discharge its duties as a fiduciary in accordance with the general standards of conduct that ERISA prescribes. The general standards of con-

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duct include the duty of prudence, the duty of loyalty, and the duty to act in accordance with the plan's governing documents to the extent that those documents are consistent with provisions of Titles I and IV of ERISA.[15] ERISA's general standards of conduct are supplemented by more rigid fiduciary responsibility provisions, including ERISA's prohibited transaction provisions.[16] Although the prohibited transaction provisions bar a fiduciary from engaging in certain transactions that might subject the fiduciary to a conflict of interest, ERISA allows any representative of a party in interest, including an officer, employee, or agent of the employer, to serve as a fiduciary.[17]

ERISA also provides that if a fiduciary breaches any of ERISA's fiduciary standards, the fiduciary is personally liable to make good to the plan any losses to the plan that result from the breach and to restore to the plan any profits that the fiduciary makes through the use of plan assets. In addition, a fiduciary that breaches ERISA's fiduciary standards may be subject to such ''equitable or remedial relief as the court may deem appropriate, including removal.'' [18]

In this article, I concentrate primarily on the application of the duty of prudence to investment decisions under participant-directed individual account plans. For reasons that I will explain, what the duty of prudence requires of a plan's fiduciaries depends on, among other things, the specific characteristics of the plan and its participants and beneficiaries. At the end of this article, I examine how differences between a typical individual account plan and a typical defined benefit plan can affect investment decisions under those plans.

SECTION 404(c)

Although fiduciaries can be held liable for failing to exercise appropriate care when they invest plan assets, ERISA §404(c) limits the liability of fiduciaries for implementing participants' instructions under participant-directed individual account plans that meet the standards prescribed by the implementing regulation issued by the Department of Labor (DOL).[19] The regulation provides that if a participant has the right to exercise control over the assets allocated to the participant's account, and the participant actually exercises such control, ''no other person who is a fiduciary with respect to such plan shall be liable for any loss, or with respect to any breach . . . that is the direct and necessary result of the participant's . . . exercise of control.'' [20]

In general terms, an individual account plan does not qualify as a ''§404(c) plan'' under the DOL regulation unless the plan provides a participant with an opportunity to exercise control over the participant's account balance and to choose from a ''broad range'' of investment options as to how the participant's account balance will be invested. According to the regulation, the ''broad range'' requirement is satisfied only if the plan's investment options provide the participant with a reasonable opportunity to affect the potential return on, and the degree of risk applicable to, the account balance; to choose from at least three investment options; and to diversify the investment of the account balance so as to minimize the risk of large losses, taking into account the nature of the plan and the size of participants' accounts. Each investment option must be diversified, must have materially different risk and return characteristics and, when combined with investments in the other options, must tend to minimize through diversification the overall risk of a participant's portfolio. In the aggregate, the investment options must enable the participant to achieve a portfolio with risk and return characteristics at any point within the range normally appropriate for the participant.[21]

Note what the DOL regulation does *not* say. It does not say that in order for a plan to qualify as a §404(c) plan, each of the plan's investment options must be ''prudent'' or that the plan's menu of investment options must be ''prudent.'' Instead, the regulation requires a §404(c) plan to offer a participant an opportunity to choose from a ''broad range'' of investment options. The menu of investment options under a participant-directed individual account plan is typically fixed either by the plan's governing documents or by a person or persons that the plan documents authorize to establish the menu.

Decisions concerning the design of an employee benefit plan are ''settlor decisions'' that are not subject to ERISA's standards of fiduciary responsibility.[22] If the menu of investment options under a participant-directed individual account plan is established by the plan's governing documents, decisions fixing the menu of investment options in those documents should be treated as ''settlor decisions.'' [23]

Plan fiduciaries are required to act in accordance with the plan's governing documents, including any menu of investment options prescribed by those documents, *except* to the extent the plan documents are inconsistent with the provisions of Titles I and IV of ERISA.[24] In consequence, plan fiduciaries are not required to act in accordance with the plan's governing documents to the extent the plan documents are inconsistent with the provisions of Title I or Title IV.[25]

The DOL's position is that because the regulation provides relief from liability only for losses that are the ''direct and necessary result'' of the participant's exercise of control, §404(c) does not provide relief from liability for losses resulting from the imprudent selection or retention of an investment option that the plan offers.[26] The validity of the DOL's position is un-

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certain. Although some courts have adopted the DOL's position, other courts have found the DOL's position to be inconsistent with the statute and the regulation itself.[27] No matter how this issue is resolved, the DOL's statements regarding the issue confirm that the duty of prudence applies to the ''selection and monitoring'' of a participant-directed plan's investment options, not to the investment options themselves.

THE DUTY OF PRUDENCE

The text and legislative history of ERISA, the prevailing case law, and the DOL's regulations establish that the duty of prudence applies to the process by which fiduciaries invest plan assets, not to the investments they make or to the investment options they offer. ERISA directs a fiduciary to —

> ''discharge his duties with respect to a plan . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity would use in the conduct of an enterprise of a like character and with like aims.'' [28]

ERISA's duty of prudence governs how fiduciaries make investment decisions. ERISA's duty of prudence prescribes how a fiduciary should conduct its duties, including any investment duties. This is made clear by the opening words of the statutory provision: ''A fiduciary shall discharge his duties . . . .''

The duty of prudence sets the standard of care that a fiduciary must meet when discharging its fiduciary duties: the fiduciary must act with ''care, skill, prudence, and diligence.'' However, the duty of prudence does not specify the particular actions that a fiduciary must take or the investments or types of investments that the fiduciary must make.[29]

Other provisions of ERISA restrict the types of investments that plans may make. For example, ERISA's prohibited transaction provisions identify the types of employer securities a plan may hold (''qualifying employer securities'') and limit the percentage of plan assets that may be invested in qualifying employer securities.[30] In addition, ERISA regulates the conditions under which a plan may hold foreign assets.[31] These restrictions reinforce the view that ERISA's general fiduciary standards, including the duty of prudence, do not specify the types of investments a fiduciary must make.

The U.S. Court of Appeals for the Fifth Circuit has emphasized that the duty of prudence governs the fiduciary's conduct, not the results of the fiduciary's conduct. In *Kirschbaum v. Reliant Energy Inc.*, employees of Reliant Energy, Inc. (REI) claimed, among other things, that REI and its Benefits Committee should have known that REI stock was not a ''prudent investment'' for REI's Savings Plan and that they had a fiduciary duty to halt purchases of REI stock, sell the Plan's holdings of REI stock, and terminate the Plan's REI Stock Fund. The Fifth Circuit's opinion includes the following observations about the employees' claim:

> ''The question is how to define when the duty of prudence might require a fiduciary to disobey the clear requirements of [a plan] and halt the purchase of employer stock. In this, as in all cases, the test of prudence is one of conduct, not results. . . . The focus of the inquiry is 'how the fiduciary acted,' not whether his investments 'succeeded or failed.' . . . The prudence requirement is a flexible standard, and a fiduciary's conduct must be evaluated 'in light of the character and aims of the particular type of plan he serves.' '' [32]

ERISA's duty of prudence requires a fiduciary to exercise the care, skill, prudence and diligence of a prudent man. The duty of prudence requires a fiduciary's ''care, skill, prudence, and diligence'' to be no less than the ''care, skill, prudence, and diligence'' of a prudent man acting in a like capacity under the circumstances then prevailing. The duty of prudence thus requires a fiduciary's conduct to meet an objective standard established by the conduct of prudent fiduciaries.[33]

ERISA's duty of prudence does not embrace the ''follow the crowd'' approach or the ''safety in numbers'' doctrine: it does not require fiduciaries to make the same investments, or the same types of investments, that other fiduciaries make.[34] To be sure, if a fiduciary has adopted an unconventional approach to investment management, it could be difficult to persuade a court that the fiduciary has complied with the duty of prudence. For example, it would be very difficult to persuade a court that our hypothetical fiduciary, Flip Coinflipper, complied with the duty of prudence by making investment decisions on the basis of coin flips. However, a fiduciary that implements an innovative approach that is thoughtful, substantiated and skillfully applied should not be disadvantaged merely because the fiduciary does not follow the crowd. ERISA was designed to protect plan participants by improving the management of plan assets, not by curtailing innovation.[35]

ERISA's duty of prudence establishes a standard of conduct that is both flexible and dynamic. ERISA's duty of prudence requires a fiduciary's care, skill, prudence and diligence to be evaluated ''under the circumstances then prevailing,'' that is, under the

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circumstances in which the fiduciary acts. The duty of prudence statute does not require all fiduciaries to act in the same way, regardless of differences in their circumstances.[36]

Similarly, because the statute requires a fiduciary's care, skill, prudence and diligence to be evaluated in light of ''the circumstances then prevailing,'' the requirements imposed by the duty of prudence are based on the circumstances at the time the fiduciary acts. The fiduciary's conduct is not evaluated on the basis of hindsight.[37]

Moreover, because the duty of prudence requires a fiduciary's conduct to be evaluated in light of the circumstances in effect at the time the fiduciary acts, the conduct that the duty of prudence requires may evolve. The conduct required by the duty of prudence in 2060 might not be identical to the conduct required in 2010.[38]

ERISA's duty of prudence has both procedural and substantive components. ERISA's duty of prudence refers to the fiduciary's ''care, skill, prudence, and diligence'' and therefore addresses both the process that a fiduciary follows in making a decision and the proficiency that the fiduciary displays in making the decision. Thus, consistent with the statutory text, courts have ruled that the duty of prudence imposes both procedural requirements (relating to the processes that a fiduciary follows) and substantive requirements (relating to the merits of the fiduciary's decision). The procedural component of the duty of prudence generally requires a fiduciary that is making an investment decision to collect information that is material to the decision, to evaluate the proposed investment thoroughly and impartially and, if assistance is needed, to retain qualified experts or consultants.[39] The substantive component of the duty of prudence relates to the merits of the fiduciary's investment decision and requires the fiduciary to make a decision that the fiduciary reasonably determines to be consistent with the information that the fiduciary has collected.[40]

ERISA's duty of prudence requires a fiduciary to make reasonable or rational investment decisions, but not necessarily the most profitable investment decisions. ERISA requires a fiduciary to meet a standard of conduct established by prudent fiduciaries in similar circumstances: ''the care, skill, prudence, and diligence . . . that a prudent man acting in a like capacity would use in the conduct of an enterprise of a like character and with like aims.'' ERISA thus requires ''prudence, not prescience.'' [41]

ERISA does not require a fiduciary to make the best or most profitable investment decisions.[42] If a fiduciary exercises the requisite degree of care, skill, prudence and diligence, meets ERISA's other requirements (such as its bar against self-dealing), and is not influenced by a conflict of interest, the courts tend to defer to the fiduciary's judgment.[43]

If a fiduciary's investment decision is actually skewed by an interest that conflicts with the interests of plan participants, it is understandable why a court might be more searching in its review of the fiduciary's decision. Because the duty of prudence is designed to protect participants, a court might be skeptical about the judgment of a fiduciary who assigns greater weight to the interests of non-participants than to the interests of participants (for example, the judgment of a fiduciary who invests in a company owned by the fiduciary's spouse in order to benefit the spouse rather than participants).[44] By contrast, the mere existence of a potential conflict of interest, without more, should not be enough to justify overruling the fiduciary's decision under the duty of prudence.[45]

Eligible individual account plans (EIAPs) and employee stock ownership plans (ESOPs) strongly encourage or require plan fiduciaries to invest in employer stock. Fiduciaries that invest, or retain investments, in employer stock face distinctive issues. For one thing, depending on the type of plan involved, the fiduciaries do not necessarily have discretion over the plan's investments in employer stock. Some plans — EIAPs [46] and ESOPs,[47] in particular — are *designed* to give participants a stake in the fortunes of their employers,[48] and some of these plans *mandate* investments in employer stock. For another, Congress has not merely permitted the fiduciaries of individual account plans to invest in employer stock, it has emphatically encouraged them to do so. ERISA facilitates investments in employer stock by exempting EIAPs from ERISA's percentage limit on the portion of plan assets that may be invested in employer stock and by exempting EIAP fiduciaries from both the duty to diversify plan assets and the duty of prudence insofar as the duty of prudence requires asset diversification.[49] Congress has also created numerous tax incentives to encourage employers to adopt ESOPs [50] and has enacted legislation emphasizing its intent to give priority to ESOPs.[51] Although the wisdom of this policy has been debated, there is no room to debate what that policy is.[52]

A number of appellate courts have sought to reconcile the objectives of the duty of prudence with the objectives of the employer stock provisions in ERISA and other federal laws. Most of these courts have ruled that if an ESOP or EIAP strongly encourages the fiduciary to invest in employer stock, but does not unconditionally require the fiduciary to do so, the fiduciary's decision to hold employer stock should be reviewed under a deferential ''abuse of discretion'' standard. Under this standard, a fiduciary's decision is presumed to be prudent or reasonable.

In *Moench v. Robertson*, for example, the Third Circuit declined to exempt an ESOP fiduciary's in-

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vestment decisions from judicial review. The court noted that trust law distinguishes between two types of directions: if the trust instrument ''requires'' the trustee to invest in a particular stock, the trustee's investment decisions are ''immune from judicial inquiry,'' but if the trust instrument merely ''permits'' such investments, the trustee's investment decisions are subject to de novo review. The situation in *Moench* fell in neither category because the fiduciaries were not unconditionally required to invest in employer stock, but were more than merely permitted to do so.

In order to avoid eviscerating the statutory preference for ESOPs, the Third Circuit declined to subject ESOP fiduciaries to de novo review (the standard that applies under trust law to a trustee who is authorized, but not encouraged or required, to make a particular investment). The court concluded that if an ESOP's trust instrument strongly encourages, but does not require, an ESOP fiduciary to invest in employer stock, the fiduciary is entitled to a presumption that its decision to invest in employer stock was prudent or reasonable and that a plaintiff can rebut the presumption only by showing that ''owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.'' [53] The Fifth, Sixth and Seventh Circuits have issued rulings that are generally consistent with the Third Circuit's ruling in *Moench*.[54]

In *Kuper v. Iovenko*, the Sixth Circuit followed *Moench*, but also stated that a plaintiff could rebut the presumption in favor of the fiduciary's decision ''by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision.'' [55] The Sixth Circuit's standard for the evidence needed to rebut the presumption cannot possibly be correct: if this standard were applied literally, a plaintiff could rebut the presumption of prudence (or reasonableness) by showing that one or more prudent fiduciaries would have made an investment decision that differs from the decision that the defendant-fiduciary made. If this were so, the presumption would lose its intended significance. Prudent fiduciaries can be expected to disagree with one another regarding many investment issues.[56] The duty of prudence was intended to impose a flexible standard that accommodates a variety of reasonable judgments on such issues.[57] Literal application of the Sixth Circuit's standard would transform ERISA's flexible duty of prudence into a rigid rule that would require all fiduciaries to march in lock step. The Sixth Circuit should have said, and probably meant to say, something along the following lines:

> A plaintiff may then rebut the presumption of reasonableness by showing that *no* prudent fiduciary acting under similar circumstances would have made *the same* investment decision.[58]

The presumption in favor of a fiduciary that acts in accordance with a plan document is supported by ERISA's plan document rule, which requires a fiduciary to discharge its duties in accordance with the governing plan documents insofar as those documents are consistent with Titles I and IV of ERISA. It bears emphasis that the plan document rule does *not* say that the plan documents are controlling only *if* they are consistent with Titles I and IV of ERISA. The text of the plan document rule suggests that Congress wanted fiduciaries to comply with the plan documents and to deviate from them only to the extent necessary to accommodate any conflicting provision in Title I or Title IV of ERISA.[59]

Fiduciaries have been sued for causing plans to dispose of employer stock, based on allegations that the plans would have been better off if they had retained the stock. In affirming the grant of summary judgment dismissing a number of such suits against the fiduciaries of the W.R. Grace & Co. savings plan, the First Circuit rejected the appellants' argument that the *Moench* presumption had a role in suits like these:

> ''Appellants seek to induce us to reject State Street's actions by having us apply a presumption of prudence which is afforded fiduciaries when they decide to retain an employer's stock in falling markets, first articulated in *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995) and *Moench*, 62 F.3d at 571–72. The presumption favoring retention in a 'stock drop' case serves as a shield for a prudent fiduciary. If applied verbatim in a case such as our own, the purpose of the presumption is controverted and the standard transforms into a sword to be used against the prudent fiduciary. This presumption has not been so applied, and we decline to do so here, as it would effectively lead us to judge a fiduciary's actions in hindsight. Although hindsight is 20/20, as we have already stated, that is not the lens by which we view a fiduciary's actions under ERISA. . . . . Rather, given the situation which faced it, based on the facts *then known*, State Street made an assessment after appropriate and thorough investigation of Grace's condition.'' [60]

It is difficult to take issue with the First Circuit's reasoning.

It is far from certain that ERISA's fiduciary standards can require the fiduciaries of an ESOP or an

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EIAP to override plan provisions that unconditionally require the fiduciaries to invest in employer stock. Like the Third Circuit in *Moench*, the district courts have distinguished plans that unconditionally require investment in employer stock from plans that strongly encourage investment in employer stock but that fall short of unconditionally requiring it.[61] Some district courts have ruled that plan fiduciaries are required to follow a plan's unconditional requirement to invest in employer stock,[62] while others have ruled that ERISA requires fiduciaries to override a plan provision that would require the fiduciaries to violate their fiduciary duties under ERISA.[63]

As the Fifth Circuit explained in *Kirschbaum v. Reliant Energy, Inc.*, most of the courts of appeal have not found it necessary to resolve this issue:

> ''[T]he REI defendants resist application of the *Moench* presumption insofar as it expressly applies only where a plan strongly favors but does not compel investment in company stock. The REI Savings Plan . . . affords no discretion to enter into other investments. This is a potent objection, for *Moench* recognized that a greater degree of deference, and hence a lesser degree of judicial scrutiny, would be appropriate to such mandatory plans. *Id.* (citing RESTATEMENT (THIRD) OF TRUSTS §228) (noting 'the trustee must comply' in such a situation unless compliance would be impossible or illegal). While *Moench* did not resolve the issue, the court clearly implies that a plan participant would bear an even heavier burden of showing a fiduciary duty breach where the plan utterly compelled investment in company stock. Like *Moench*, however, we decline to speculate on the scope of a fiduciary duty to override clear and unequivocal plan terms. In this case, . . . Kirschbaum's allegations fail to rebut the *Moench* presumption of prudence.'' [64]

The Fifth Circuit added:

> ''In most comparable circuit court opinions, the benefits plan at issue left the fiduciary some discretion to take the action plaintiffs were seeking. *See Edgar*, 503 F.3d at 347 n.11; *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 416–17 (4th Cir. 2007); *Moench*, 62 F.3d at 571. One exception is the Ninth Circuit's decision in *Wright v. Oregon Metallurgical Corp.*, where the fiduciaries had no discretion to take the requested action. 360 F.3d 1090, 1097 (9th Cir. 2004) ('Selling the stock in either scenario would have been in violation of the Plan's express terms.') The *Wright* court did not find it necessary to proceed beyond *Moench*, concluding that even under the *Moench* standard plaintiff could not prevail. *Id.* at 1097–98.'' [65]

By contrast, in *Kuper v. Iovenko*, the Sixth Circuit stated that an ESOP may not unconditionally require fiduciaries to invest in employer stock. However, the court had no need to address this issue because the court ruled that the plaintiffs had failed to rebut the *Moench* presumption that, in investing in employer stock, the fiduciaries had acted reasonably. As a result, it did not matter in *Kuper* whether an ESOP could unconditionally require fiduciaries to invest in employer stock. The defendants prevailed regardless of how that issue was resolved.

The Sixth Circuit's position in *Kuper* was based on its reading of the Third Circuit's opinion in *Moench*. According to the Sixth Circuit, *Moench* held that ERISA prohibited an ESOP from unconditionally requiring its fiduciaries to invest in employer stock:

> ''[T]he purpose of ESOPs cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit plans. . . . Therefore, a plan provision that completely prohibits diversification of ESOP assets necessarily violates the purposes of ERISA. ERISA provides that a fiduciary may only follow plan terms to the extent that the terms are consistent with ERISA. . . . In *Moench*, the Third Circuit held that a fiduciary's argument that he was prohibited from diversifying an ESOP under the terms of the plan that he administered was untenable because it was 'inconsistent with ERISA, inasmuch as it constrained the [fiduciary's] ability to act in the best interest of the beneficiaries.' . . . We agree and thus reject defendants' argument that the Plan provisions left them no discretion to diversify.'' [66]

The Sixth Circuit's opinion misstated the holding in *Moench*. In *Moench*, the Third Circuit did state that interpreting an ESOP to deprive its fiduciaries of all investment discretion would conflict with the common law rule that a trustee in certain narrow instances must take actions that are contrary to the trust instrument. However, the Third Circuit ruled that the ESOP in that case did *not* ''absolutely require'' investment in employer stock and gave its fiduciaries limited discretion over investment decisions — a point that the Third Circuit reemphasized in its decision in *Edgar v. Avaya*.[67]

Notwithstanding the Sixth Circuit's *Kuper* opinion, there is much to be said for the view that, as long as

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the employer stock in question is a qualifying employer security, the fiduciaries of an ESOP or EIAP have a duty *not* to override the plan's unconditional requirement to invest in employer stock.[68] That view (a) assures that the plan will be administered in accordance with the settlor's intent, (b) advances the congressional policy favoring employee stock ownership, (c) avoids putting fiduciaries in an untenable ''heads I win, tails you lose'' position where they can be held liable regardless of whether they cause the plan to sell (or to refrain from buying) employer stock (on the ground that this violates the plan document) or they allow the plan to continue to buy and hold employer stock (on the ground that this violates the duty of prudence), (d) avoids requiring fiduciaries to harm the plan and its participants by selling off the plan's stock holdings and driving down the stock price, and (e) avoids requiring fiduciaries to choose between violating the securities laws (by trading on the basis of nonpublic information) and violating the duty of prudence (by adhering to the plan document).[69]

The text of ERISA supports the view that the fiduciaries of an ESOP or EIAP have a duty not to override an unconditional requirement in the plan to invest in employer stock. In general, ERISA's plan document rule requires a plan's fiduciaries to discharge their fiduciary duties in accordance with the governing plan documents. The one exception recognized by the statute applies only insofar as the governing plan documents are inconsistent with Title I or Title IV of ERISA.[70] Because ERISA itself both imposes the duty of prudence and affirmatively encourages ESOPs and EIAPs to invest in employer stock, an ESOP or EIAP provision requiring investment in employer stock need not be regarded as inconsistent with the duty of prudence.[71] The district courts are divided on this issue, however, and it remains to be seen how the appellate courts will resolve the issue.

ERISA's legislative history is consistent with the text of the statute's prudence provision. The Supreme Court has observed that ''ERISA abounds with the language and terminology of trust law.'' [72] ERISA's legislative history makes clear that ERISA was intended to apply ''rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries,'' [73] but with the expectation 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.'' [74] Rather than define all of a fiduciary's duties, Congress invoked the common law of trusts to define fiduciaries' duties, subject to ''modifications appropriate for employee benefit plans.'' [75] Consistent with the reference in ERISA's legislative history to appropriate ''modifications'' to the common law of trusts, the Supreme Court has observed that ''the law of trusts often will inform, but will not necessarily determine the outcome of, an effort to interpret ERISA's fiduciary duties.'' [76]

The common law duty of prudence generally requires a fiduciary to exercise the same degree of care and skill that a man of ordinary prudence would exercise in dealing with his own property.[77] ERISA's prudence provision, however, was based on the prudence provision in H.R. 16462, an Administration bill that was introduced in 1970. In testimony before the House Education and Labor Committee's Subcommittee on Labor, the Administration contended that, unlike the common law rule, its prudence proposal was sufficiently flexible to regulate appropriately the diverse array of employee benefit plans:

> ''Our formula has a built in flexibility to allow for fair judgments to be made whether the fiduciary is an individual administering a small plan with an uncomplicated portfolio or an institution administering a large plan with millions of dollars invested in many types of assets.
>
> ''Under H.R. 16462, a fiduciary will be judged by a standard of prudence in light of all the circumstances prevailing at the time he acts. Thus in any given transaction, a trust company, for example, would be evaluated in terms of other trust companies under similar circumstances, including the prevailing economic conditions, nature, size and goals of the plan, the nature of the transaction itself, as well as the standards expected of such specialized financial institutions.
>
> ''This does not mean that the standard will necessarily be a higher or lower standard than would be imposed under the traditional formulation. It will be a fairer standard, which recognizes the vast diversity and other characteristics of private pension and welfare plans.'' [78]

Consistent with the intention to provide fiduciaries with flexibility, Congress chose *not* to impose ''legal list'' rules that had previously constrained trustees in some jurisdictions. The ''legal list'' rules in the United States stemmed from the English common law of trusts, which allowed trustees to invest only in Government securities unless the trust instrument provided otherwise. In the United States, some states adopted ''legal lists'' of court-approved or legislatively approved trust fund investments which were initially limited to specified types of bonds and mortgages and were later expanded to include other instruments.[79]

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The Supreme Judicial Court of Massachusetts led the movement away from ''legal list'' rules. In *Harvard College v. Amory*, the court adopted what became known as the ''prudent man rule'' [80] under which trustees were required to

> ''observe how men of prudence . . . manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested.'' [81]

One legal scholar has made the following observations regarding the Massachusetts rule:

> ''The Massachusetts rule represented a great advance by abandoning the attempt to specify approved types of investment. Prudence is another word for reasonableness, and the prudent man rule echoed the contemporaneously developed reasonable man rule in the law of negligence. The standard of prudent investing was the standard of industry practice — what other trustees similarly situated were doing.'' [82]

By the mid-twentieth century, many states had adopted a version of the prudent man rule that had been advocated by the American Bankers Association. New York, for example, gradually increased the percentage of trust assets that was not subject to its legal list rule, and adopted the prudent man rule in 1970.[83] Fiduciaries' resistance to detailed regulation of their conduct has been identified as one of the key factors contributing to the states' abandonment of the legal list rule.[84] Although the Massachusetts prudent man rule was more flexible than the legal list rules, the courts initially tended to apply the prudent man rule by focusing on the performance of individual securities rather than on the performance of the entire portfolio, to give little weight to the benefits of diversification, and to focus more on loss-avoidance than on risk/return analysis.[85]

By contrast, the courts today tend to apply the common law prudence standard in accordance with contemporary investment practices.[86] The evolution of the common law duty of prudence is reflected in the Restatement (Third) of Trusts:

> ''The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent investor would, in light of the purposes, terms, distribution requirements, and other circumstances of the trust.
>
> ''A. This standard requires the exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
>
> ''B. In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so . . . .'' [87]

The General Comment on the Restatement's treatment of the duty of prudence states:

> ''In the absence of a contrary statutory provision, a trustee may generally invest in such properties and in such manner as expressly or impliedly authorized by the terms of the trust. . . . The trustee's compliance with these fiduciary standards is to be judged as of the time the investment decision was made, not with the benefit of hindsight or by taking account of developments that occurred after the time of a decision to make, retain, or sell an investment. The question of whether a breach of trust has occurred turns on the prudence and propriety of the trustee's conduct, not on the eventual results of investment decisions. The trustee is not a guarantor of the trust's investment performance.'' [88]

The Comment on Prudent Investing observes that ''[t]here are no universally accepted and enduring theories of financial markets or prescriptions for investment that can provide clear and specific guidance to trustees and courts. Varied approaches to the prudent investment of trust funds are therefore permitted by the law.'' [89] The Comment identifies the following generally agreed-upon principles:

> ''1. Trustees, like other prudent investors, prefer (and, as fiduciaries, ordinarily have a duty to seek) the lowest level of risk and cost for a particular level of expected return — or, inversely, the highest return for a given level of risk and cost.
>
> ''2. Specific investments or techniques are not per se prudent or imprudent. The riskiness of a specific property, and thus the propriety of its inclusion in the trust estate, is not judged in the abstract but in terms of its anticipated effect on the particular trust's portfolio . . . .'' [90]

The evolution of the common law duty of prudence is thus consistent with the flexible and dynamic character of the ERISA duty of prudence.

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DOL regulations confirm the flexible and dynamic character of ERISA's duty of prudence and make clear that the duty of prudence governs the process of investing, not the investments that fiduciaries make. In 1979, less than five years after ERISA was enacted, the DOL issued a regulation creating a ''safe harbor'' for fiduciaries with investment responsibilities. Under the regulation, fiduciaries who qualify for the safe harbor are deemed to comply with the duty of prudence.[91] The regulation does not address the treatment of fiduciaries who do not qualify for the safe harbor.[92]

The regulation provides that a fiduciary is deemed to comply with the duty of prudence with respect to an investment or an investment course of action (i.e., a series or program of investments) if the fiduciary gives ''appropriate consideration'' to the facts and circumstances that the fiduciary knows or should know are relevant, including the role that the investment or investment course of action plays in the fiduciary's investment portfolio, and acts accordingly. Under the regulation, ''appropriate consideration'' includes both (1) a determination that the particular investment or investment course of action is reasonably designed, as part of the portfolio, to advance the plan's objectives, taking into account the risk of loss and the opportunity for gain; and (2) consideration of (a) the diversification of the portfolio, (b) the liquidity and return of the portfolio, and (c) the projected return of the portfolio.

The preamble to the regulation states that the relative riskiness of a specific investment does not cause the investment to be either per se prudent or per se imprudent:

> ''The Department is of the opinion that (1) generally, the relative riskiness of a specific investment or investment course of action does not render such investment or investment course of action either *per se* prudent or *per se* imprudent, and (2) the prudence of an investment decision should not be judged without regard to the role that the proposed investment or investment course of action plays within the overall plan portfolio. Thus, although securities issued by a small or new company may be a riskier investment than securities issued by a 'blue chip' company, the investment in the former company may be entirely proper under the Act's 'prudence' rule.'' [93]

Both the DOL regulation and the preamble reflect the influence of modern portfolio theory, a widely accepted body of empirical and theoretical learning about the behavior of investment markets that prompted the reformation of trust investment law in the second half of the twentieth century.[94] One of the key conclusions of modern portfolio theory is that an investment portfolio can realize very substantial gains and reduce its exposure to risk, at little or no cost, through diversification of the portfolio's investments[95] — the approach contemplated by the regulation.[96]

In 2006, in the course of directing the DOL to clarify a 1995 interpretive bulletin, Congress confirmed that the duty of prudence governs the fiduciary's conduct rather than the fiduciary's investments. The DOL's 1995 interpretive bulletin stated that if a fiduciary purchased an annuity contract for purposes of making distributions from a plan, the fiduciary must select the ''safest available annuity,'' based on the annuity provider's claims-paying ability and creditworthiness, unless it was in the interest of participants to do otherwise. In the Pension Protection Act of 2006 (the PPA), Congress directed the DOL to clarify that the interpretive bulletin's ''safest available annuity'' standard does not apply to the selection of an annuity contract under an individual account plan, but that all other applicable fiduciary standards *do* apply to the selection of an annuity contract under such a plan. It bears emphasis that the PPA provided that ''the selection of an annuity contract,'' not the annuity contract itself, is subject to all applicable fiduciary standards other than the ''safest available annuity'' standard.

In 2008, in accordance with the PPA, the DOL issued a regulation creating a prudence ''safe harbor'' for the selection of an annuity provider and annuity contract for benefit distributions from an individual account plan. A fiduciary qualifies for the safe harbor if the fiduciary (1) engages in an objective and thorough search to identify and select annuity providers; (2) appropriately considers information sufficient to assess the provider's ability to make all future payments required by the contract and the cost of the contract in relation to the benefits and services to be provided; (3) appropriately concludes, at the time of selection, that the provider will be able to make all of the payments required by the contract and that the cost is reasonable in relation to the benefits and services to be provided under the contract; and (4) consults with appropriate experts if necessary.[97]

Thus, both the 1979 and the 2008 DOL regulations govern fiduciary conduct and do not impose categorical limits on the investments that fiduciaries may make. Each regulation:

- provides that fiduciaries are deemed to comply with the duty of prudence if they meet an objective standard of conduct;
- establishes a standard of conduct that is both flexible and dynamic insofar as the regulation allows

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a fiduciary to qualify for a safe harbor if the fiduciary meets a standard that takes into account the fiduciary's circumstances at the time the fiduciary acts;

- establishes both procedural and substantive requirements that a fiduciary must meet in order to qualify for a safe harbor; and
- provides that a fiduciary qualifies for a safe harbor if the fiduciary's conduct is consistent with the relevant facts.

FIDUCIARY LIABILITY

Under ERISA, a fiduciary is personally liable to compensate the plan only for those losses that result from the fiduciary's breach of fiduciary duty.[98] ERISA also provides that a fiduciary that violates ERISA's standards of conduct is personally liable to restore to the plan any profits that the fiduciary makes through the use of plan assets. In addition, a fiduciary that violates ERISA's standards of conduct is subject to any "equitable or remedial" relief that a court considers appropriate.[99]

Breach. ERISA does not require fiduciaries to guarantee the plan's investment performance. If a fiduciary does not breach its fiduciary duties, or knowingly participate in a breach by another fiduciary,[100] the fiduciary is not liable to the plan for any losses that the plan incurs, including any losses that are caused by the fiduciary's investment decisions.[101]

Profit to the fiduciary or loss to the plan. ERISA provides that if a fiduciary breaches the duty of prudence, but does not profit from the use of plan assets, the fiduciary is personally liable to make good to the plan only losses that the plan incurs as a result of the fiduciary's breach. If a fiduciary breaches the duty of prudence, but the fiduciary does not make a profit through the use of plan assets and the plan does not incur a loss as a result of the breach, ERISA does not authorize a monetary award against the fiduciary.[102]

Causation. A fiduciary that breaches its fiduciary duties is not subject to strict liability for any losses that the plan subsequently incurs.[103] If a fiduciary breaches the duty of prudence, and the plan later incurs a loss, the fiduciary is not required to reimburse the plan for the loss unless the fiduciary's breach caused the plan to incur the loss. In *Diduck v. Kaszycki & Sons Contractors, Inc.*,[104] for example, the Second Circuit ruled that in order for plaintiffs to recover on a fiduciary breach claim, there must be a causal connection between the fiduciary breach and the loss to the plan:

> "The last element in this cause of action is proof of a causal connection between the fraud perpetrated and the loss complained of. The same causal connection is required between a breach of fiduciary duty and the loss alleged. . . . Thus, [defendants] may not be held liable for contributions owing the funds unless, absent a fraudulent breach, the funds could have collected them." [105]

If a fiduciary breach does not cause the plan to incur a loss (for example, because the fiduciary was imprudent, but had the good fortune to make the same decision that a prudent fiduciary would have made in the same circumstances), the fiduciary is not required to make good to the plan any loss that the plan incurs.[106] Even in the absence of a loss that results from a breach of fiduciary duty, however, ERISA allows an action to be brought against a fiduciary for injunctive relief.[107]

Some court decisions can be read to say that a fiduciary does not violate the duty of prudence unless the fiduciary's conduct results in a loss to the plan.[108] If this is what the courts meant to say, the courts' statements are inconsistent with the statute. ERISA's duty of prudence provision makes no reference to a loss.

A better reading of these court decisions is that if a fiduciary did not profit from the use of plan assets, plaintiffs cannot obtain a monetary award in a fiduciary breach suit unless they can prove both that the alleged breach occurred and that the breach caused the plan to incur a loss.[109] Justice (then Judge) Scalia explained this in his oft-cited dissent in *Fink v. National Savings & Trust Co.*[110] The issue in *Fink* was whether ERISA's three-year statute of limitations[111] barred a suit charging breach of fiduciary duty in connection with the acquisition and retention of employer stock. The defendants argued that the three-year statute started running when the employer filed with the Department of Labor reports that disclosed the alleged breach. The majority ruled that ERISA's statute of limitations did not bar the suit.[112] Justice Scalia dissented in part on the ground that (1) the duty of prudence obligates a plan fiduciary both to investigate investments and to invest prudently, (2) a breach of the duty to investigate is actionable under ERISA only for equitable relief, (3) the duty allegedly breached in *Fink* (sustaining plaintiffs' claim for a monetary award) was the duty to invest prudently, and (4) facts sufficient to make plaintiffs aware that they had an imprudent investment claim were disclosed on the face of the annual reports filed for the ESOP, which started the running of ERISA's three-year statute of limitations. In other words, although the duty of prudence requires a fiduciary to act with care, skill, prudence *and* diligence, the only basis for the plaintiffs' action for a monetary award was the defendants' alleged failure to invest prudently, which had been disclosed on the ESOP's annual reports.

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In *Bussian v. RJR Nabisco, Inc.*,[113] a case involving the purchase of annuity contracts in connection with the termination of a defined benefit pension plan, the Fifth Circuit likewise differentiated the duty to investigate from the duty to invest prudently:

> ''The relevant inquiry in any case is whether the fiduciary, in structuring and conducting a thorough investigation of annuity providers, carefully considered [the factors enumerated by the DOL in IB 95-1] and any others relevant under the particular circumstances it faced at the time of the decision. If so, a fiduciary satisfies ERISA's obligations if, based on what it learns in its investigation, it selects an annuity provider it reasonably concludes best to promote the interests of [the plan's] participants and beneficiaries. If not, ERISA's obligations are nonetheless satisfied if the provider selected would have been chosen had the fiduciary conducted a proper investigation.'' [114]

Thus, according to the Fifth Circuit, if a fiduciary is alleged to have violated the duty of prudence in making investments for a plan, the fiduciary might have two defenses. The first is that the fiduciary satisfied the requirements of procedural and substantive prudence. The second is that even if the fiduciary did not satisfy the requirements of procedural and substantive prudence, the fiduciary's investment decisions produced results that were at least as favorable to the plan as those that would have been produced by the decisions of a fiduciary who satisfied the duty of prudence.[115] Although the second defense can be invoked to defeat a claim for a monetary award, it might not defeat a claim for equitable relief.[116]

"PRUDENT INVESTMENTS"

The text and legislative history of ERISA, the history of the common law duty of prudence, the DOL's regulations, and the case law establish that, under ERISA, investments are neither prudent nor imprudent. Nevertheless, the DOL has mistakenly suggested on a number of occasions that investments can be prudent or imprudent. For example:

- ***Preamble to Participant-Directed Individual Account Plan Regulation:*** The preamble to the DOL's regulation on participant-directed individual account plans under §404(c) of ERISA — but not the regulation itself — refers to both the fiduciary obligation for the prudent selection and monitoring of the plan's investment option and the *prudence* of the plan's investment options and the investment portfolio.[117]
- ***Preamble to Default Investment Option Regulation:*** The preamble to the DOL's regulation on default investment options under participant-directed individual account plans – but not the regulation itself — refers to both the fiduciary obligation regarding the prudent selection and monitoring of the default investment option and the *prudence* of the investment options themselves.[118]
- ***Directed Trustee Bulletin:*** The DOL's Field Assistance Bulletin regarding the fiduciary duties of a directed trustee states that if a plan requires a directed trustee to carry out transactions according to a named fiduciary's instructions, the ''named fiduciary has primary responsibility for determining the *prudence* of a particular transaction'' and the ''directed trustee does not . . ., have an independent obligation to determine the *prudence* of every transaction.''[119]
- ***ETI Bulletin:*** The DOL's Interpretive Bulletin (IB) on economically targeted investments (ETIs) treats an investment as an ETI if the investment is made because of an economic benefit other than the investment return that the investment generates for the plan (for example, the creation of jobs for plan participants). The IB concludes that because every investment requires a plan to forgo other investment options, an ETI is not *prudent* if its expected rate of return is lower than the expected rate of return on available alternative investments that are no more risky than the ETI or if the ETI is riskier than available alternative investments with commensurate (or better) rates of return.[120]
- ***Voluntary Fiduciary Correction Program:*** The DOL's voluntary fiduciary correction program provides that where a plan has sold property to a party in interest in a nonexempt prohibited transaction, the prohibited transaction may be corrected if the plan repurchases the property from the party in interest and meets certain conditions. One of the conditions is that an independent fiduciary determines that the property is a *prudent* investment.[121]
- ***"A Look at 401(k) Plan Fees":*** This DOL pamphlet asserts that the duty of prudence requires employers both to ''establish a prudent process for selecting investment alternatives and service providers'' and to ''select investment alternatives that are *prudent* and adequately diversified.'' [122]
- ***Information Letter Regarding Derivatives:*** In a 1996 information letter to the Comptroller of the Currency, the DOL stated that ''[i]nvestments in derivatives are subject to the fiduciary responsibility rules in the same manner as are any other

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> plan investments. Thus, plan fiduciaries must determine that an investment in derivatives is, among other things, *prudent* and made solely in the interest of the plan's participants and beneficiaries." The remainder of the letter, however, focuses on the conduct of the responsible fiduciaries rather than on the nature of the derivatives.[123]

Similarly, some court decisions have mistakenly suggested that each investment option offered by a participant-directed individual account plan must be "prudent" or that the plan's entire menu of investment options must be "prudent" — even though no such requirement appears in ERISA or in the DOL regulation concerning participant-directed plans.[124]

In addition, the plaintiffs in over 20 putative class actions filed since September 2006 (the "investment fund" cases) — at least 15 of which were filed by one law firm — have contended that ERISA requires fiduciaries of participant-directed individual account plans to make prudent investment options available to plan participants. Among the claims made, or viewed by the courts as having been made, in these cases are claims that the defendants maintain "imprudent investment options" [125] or "an imprudent menu of investment options," [126] and claims "that the decision to include retail mutual funds is nearly per se imprudent," [127] that specific mutual funds have become imprudent,[128] that it is imprudent to offer a money market fund rather than a stable value fund,[129] and that it is imprudent to structure a company stock fund as a unitized fund rather than as a direct ownership fund.[130]

Further, several district courts have issued rulings that apply the duty of prudence to plan investments rather than to fiduciary conduct. In *In re Uniphase Corp. ERISA Litig.*,[131] the district court denied a defense motion to dismiss the plaintiffs' claim against the fiduciaries of an EIAP sponsored by JDS Uniphase Corp. (JDSU), primarily on the ground that the plaintiffs' claim was not a diversification claim but instead a claim that the employer's stock "was — itself — an imprudent investment." [132] The court concluded that because "plaintiffs allege that any investment in JDSU stock was imprudent in light of what the defendants knew about JDSU and the risk of investing in JDSU stock," they were not making a diversification claim that might have been subject to dismissal on account of the EIAP exemption.[133] The court's reference to what the fiduciaries allegedly knew about JDSU suggests that the court might have referred to the allegation that JDSU stock "itself" was an "imprudent investment" only to distinguish the plaintiffs' claim from a diversification claim and that the court was simply using a short-hand expression to refer to the imprudence of the fiduciaries' decision to permit investments in JDSU stock.[134]

Comments in two subsequent federal district court rulings, however, cannot be explained away as mere "short-hand expressions." In *In re Ford Motor Co. ERISA Litig.*,[135] the district court upheld a magistrate judge's recommendation to deny a motion to dismiss a prudence claim against the fiduciaries of Ford's ESOPs. The court found that the plaintiffs had not made a diversification claim and that the EIAP exemption requires courts to evaluate the prudence of employer stock funds (apart from their lack of diversification). The court concluded that the plaintiffs' claim — that Ford stock was an imprudent investment because it was so risky — was cognizable under ERISA:

> "[T]he statutory language plainly retains the duty of prudence except insofar as it would dictate diversification. . . . As a result, this Court finds that the *Kuper* presumption of prudence means that 29 U.S.C. §1104(a)(1)–(2) requires fiduciaries to divest their plans of company stock when holding it becomes so risky — that is, so imprudent — that the problem could not be fixed by diversifying into other assets. In other words, with respect to EIAPs, an abuse of discretion under *Kuper* begins (and the presumption of prudence ends) at the point at which company stock becomes so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would invest *any* plan assets in it, regardless of what other stocks were also in that plan's portfolio." [136]

The excessive-risk standard was also adopted by the district court for Minnesota in *Morrison v. MoneyGram, Inc.*:

> "[T]his excessive-risk standard comports with the statutory exemption from the diversification requirement. The *Moench* presumption may not be overcome by proof that the EIAP fiduciary invested *too heavily* in employer stock, but only by proof that the fiduciary should not have invested *at all* in employer stock. . . .
>
> "Plaintiffs allege that MoneyGram was suffering enormous investment losses throughout the class period — approximately $1.6 billion at last count. Plaintiffs further allege that these losses were due to MoneyGram's pursuit of an extraordinarily speculative and unnecessary investment strategy that involved borrowing money and investing it in risky mortgage-backed securities. This strategy, plaintiffs allege, put at least two-thirds of

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> MoneyGram's investment portfolio at risk . . . . Under these conditions, plaintiffs allege, MoneyGram's stock price was poised to collapse . . .
>
> "In the Court's view, these allegations, taken as a whole, sufficiently allege that at some point '[MoneyGram] stock [became] so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would [have] invest[ed] *any* plan assets in it, regardless of what other stocks were also in th[e] plan's portfolio.' " [137]

The excessive-risk standard adopted by the district courts in *Uniphase*, *Ford* and *MoneyGram* is misguided. First, the very idea that a security might be too risky to invest *any* plan assets in it conflicts with a key teaching of modern portfolio theory: that the current market price of a marketable security reflects the riskiness of the security. Further, a diversified investment portfolio can reduce the risk of a high-risk investment.[138]

Moreover, because the excessive-risk standard is based on the abstract question whether *any* shares of employer stock would be acceptable as an investment and disregards the actual composition of the plan's portfolio, the excessive-risk standard is inconsistent with the statute. In another case involving employer stock, the Court of Appeals for the Fourth Circuit observed:

> "[A] fiduciary cannot free himself from his duty to act as a prudent man by arguing that other funds, which individuals may or may not elect to combine with a company stock fund, could theoretically, in combination, create a prudent portfolio [*sic*].. . . To adopt the alternative view would mean that any single-stock fund, in which that stock existed in a state short of certain cancellation without compensation, would be prudent if offered alongside other, diversified Funds. Any participant-driven 401(k) plan structured to comport with section 404(c) of ERISA would be prudent, then, so long as a fiduciary could argue that a participant could, and should, have further diversified his risk." [139]

Although the Fourth Circuit's reference to a "prudent portfolio" is mistaken, its basic point seems sound: a fiduciary should not be permitted to defend an imprudently selected investment on the ground that the imprudently selected investment could have been combined with other investments to form a prudently constructed portfolio.[140]

In addition, because the excessive-risk standard requires a court to evaluate the riskiness of employer stock, the excessive-risk standard may require courts to make determinations that they are not qualified to make. The Seventh Circuit has expressed doubt about the courts' competence to decide when a fiduciary of an ESOP must sell employer stock that the ESOP requires it to hold:

> "[E]ven if the methods of litigation could feasibly determine the point at which the ESOP trustee should sell in order to protect the employee-shareholders against excessive risk, the plaintiffs have made no effort to establish that point. . . .
>
> "There has thus been a failure of proof. *But the plaintiffs can take some solace from the fact that determining the 'right' point, or even the range of 'right' points, for an ESOP fiduciary to break the plan and start diversifying may be beyond the practical capacity of the courts to determine.*" [141]

Plan fiduciaries are better positioned to make decisions regarding the suitability of employer stock for an ESOP. One of Congress's objectives in enacting ERISA was to encourage employers to provide benefit plans for their employees.[142] Congress sought to achieve this objective by allowing employers to establish plans that could be administered on a cost-effective basis.[143] This objective was advanced by allowing employers to assign principal responsibility for investment decisions to designated plan fiduciaries.

A legal doctrine that requires courts to substitute their judgment for the judgment of the plan's designated fiduciaries, rather than to *review* the judgment of the fiduciaries, would undermine this important congressional objective. If employers cannot be assured that their intentions in establishing employee benefit plans will be implemented by the fiduciaries they have designated, they will be less likely to establish benefit plans for their employees and more likely to terminate plans they have already established.[144]

Thus far at least, the courts have resolved the "unitized fund" claims being made in the investment fund cases in a more satisfactory way. A unitized employer stock fund invests primarily in employer stock, but also holds cash or cash equivalents. Each participant who invests in a unitized employer stock fund is treated as owning fund "units" rather than shares of employer stock. Plaintiffs in the investment fund cases claim, among other things, that both the structure of a unitized employer stock fund and the holding of cash or cash equivalents in a unitized employer stock fund violate ERISA's prudence requirement.[145]

The reason why many individual account plans hold employer stock in unitized funds rather than in

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direct ownership funds is that many plans allow participant-initiated transactions involving other investment funds (for example, reallocation of a participant's account balance among the plan's investment funds) to settle on the date of the transaction, whereas the sale of a share of common stock typically does not settle until three days after the sale occurs. The three-day lag prevents participants with a direct ownership interest in employer stock from effecting sales of employer stock on the date they instruct the plan to sell. By contrast, a unitized fund allows participants to settle their stock trades within one business day, and the fund's cash reserves allow the fund to cover the sales. A unitized fund thus allows participants to settle their stock trades on the same schedule that applies to other participant-initiated transactions under the plan.

If the employer stock held by a unitized stock fund appreciates at a rate that exceeds the rate that the unitized employer stock fund earns on its cash reserves, the fund's cash reserves reduce the fund's rate of return. However, because cash reserves are less volatile than is a single equity security, an investment in a unitized fund is exposed to less risk than is an investment in a direct ownership fund, and any assessment of a unitized fund's rate of return must also take into account the unitized fund's reduced exposure to investment risk.

If the governing plan documents require a participant-directed individual account plan to offer a unitized employer stock fund as an investment option, the decision to offer a unitized employer stock fund should be regarded as a ''settlor decision'' that is not covered by ERISA's fiduciary standards. In the absence of any inconsistency between the plan provisions requiring the plan to offer a unitized stock fund and the provisions of Title I or Title IV of ERISA, ERISA would require the plan's fiduciaries to implement the plan's directive to offer a unitized employer stock fund.

By contrast, if the governing plan documents give plan fiduciaries discretion to determine the terms on which the plan will offer employer stock as an investment option, it might not be possible to characterize the fiduciaries' decision to offer a unitized fund as a ''settlor decision.'' In such circumstances, if the fiduciaries are sued by a plaintiff who claims that the fiduciaries violated the duty of prudence when they decided to establish a unitized employer stock fund, the fiduciaries would have to defend their decision on the ground that they had exercised their authority under the plan in accordance with the duty of prudence.

In two of the investment fund cases (*United Technologies* and *Edison International*), the courts upheld the latter defense (based on the duty of prudence) and rejected claims that unitized employer stock funds were ''imprudent'' and held ''too much cash.'' The courts analyzed the unitized employer stock funds by focusing, as the statute directs, on the conduct of the fiduciaries, and found that the plans' fiduciaries had carefully considered the structure of the funds and monitored the funds' cash reserves.[146]

The courts recognized that there is no single ''prudent'' decision that a fiduciary must make, that there is a range of reasonable decisions that a prudent fiduciary may make in a given situation, and that it is up to the responsible fiduciary, not the court, to make the decision that, in the fiduciary's judgment, is most appropriate. As Judge Wilkinson has observed, Congress assigned responsibility for plan administration to fiduciaries ''whose experience is daily and continual,'' not to ''judges whose exposure is episodic and occasional.''[147] This is especially true in connection with investment issues that are debated by investment professionals and on which courts have no expertise. As Judge Posner has observed, such determinations ''may be beyond the practical capacity of the courts.''[148]

The common law of trusts — the foundation of ERISA's fiduciary responsibility provisions[149] — likewise requires courts to defer to trustees' reasonable exercise of their discretionary authority.[150] Under the common law of trusts, ''judicial intervention is not warranted merely because the court would have differently exercised [its] discretion.''[151] Consistent with the common law precedents, plan fiduciaries — not the federal courts — should be primarily responsible for plans' investment decisions.[152]

INDIVIDUAL ACCOUNT PLANS AND DEFINED BENEFIT PLANS

The duty of prudence applies to the fiduciaries of both individual account plans and defined benefit plans. Although ERISA's prudence provision does not refer directly to either type of plan, the prudence provision compares a fiduciary's conduct ''in the circumstances then prevailing'' to the conduct of a prudent man ''in the conduct of an enterprise of a like character and with like aims.'' Because the duty of prudence measures a fiduciary's conduct against the conduct of a prudent man under a plan ''of a like character and with like aims,'' the duty of prudence necessarily requires a fiduciary to take into account the plan's character as an individual account plan or a defined benefit plan.[153]

Even plans of the same type can have markedly different needs. For example, because the needs of a participant-directed §401(k) plan can differ significantly from those of an employer-managed money purchase pension plan, fiduciaries under the two plans are likely to approach investment decisions very differently.[154] Likewise, a fiduciary under a vibrant, on-

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going defined benefit plan might approach investment decisions quite differently if conditions change and the fiduciary learns that a decision has been made to terminate or split up the plan.[155] It is even more likely that the differences between a typical individual account plan and a typical defined benefit plan will significantly affect investment decisions under those plans.

Investment Risk. Participants bear all of the investment risk under an individual account plan, while the employer bears most of the investment risk under an ongoing defined benefit plan. Accordingly, if the employer has more tolerance for investment risk than do its employees, a plan fiduciary might reasonably conclude that the assets of a defined benefit plan can be invested more aggressively than can the assets of an individual account plan. However, if the employer's ability to tolerate investment risk declines, the duty of prudence would not bar a fiduciary of the defined benefit plan from taking into account the employer's changed circumstances in determining the plan's exposure to investment risk.[156]

In fiduciary breach cases involving participant-directed individual account plans, plaintiffs often assert that the plan's fiduciaries violated the duty of prudence by offering one or more excessively risky investment options. In some cases, the fiduciaries defend their conduct by arguing, among other things, that each participant has the right to allocate his or her account balance among all of the plan's investment options, that the plan's investment portfolio as a whole is diversified and not excessively risky, and that the riskiness of any individual investment option is irrelevant. The courts have generally rejected the fiduciaries' "investment portfolio" argument and have ruled that the duty of prudence requires a fiduciary's selection of an investment option to be evaluated on its own and not exclusively as part of a decision regarding the composition of the plan's entire investment portfolio.[157]

In so ruling, the courts have relied on the distinction between participant-directed individual account plans and other plans (primarily defined benefit plans). Under a defined benefit plan, each participant's benefits are typically secured by all of the plan's assets, and the plan's investment portfolio is typically managed on an integrated basis. By contrast, under a participant-directed individual account plan, each participant's benefits depend on the performance of the investment funds that the participant elects, and there is no assurance each participant will diversify the assets in his or her account.

However, the fiduciaries have a point. When the fiduciaries of a participant-directed individual account plan select the investment funds that the plan will offer to plan participants, the fiduciaries should (and typically do) take the plan's other investment funds into account. Indeed, the DOL's §404(c) regulation provides that a plan does not qualify as a §404(c) plan unless the plan allows a participant to allocate his or her account among a "broad range" of investment options. It therefore seems entirely appropriate for plan fiduciaries to take the design of a participant-directed plan into account when they assess the plan's individual investment funds.

Investment Policy. The text of a defined benefit plan may offer guidance to the plan's fiduciaries regarding the employer's ability or willingness to tolerate investment risk. The text of an individual account plan may likewise offer investment guidance to the plan's fiduciaries. For example, if the plan is participant-directed, the text of the plan or trust agreement may specify, by name or by category, the investment options that the plan must offer. Regardless of whether the plan is a defined benefit plan or an individual account plan, the fiduciary is obliged to make investment decisions that conform to such guidance insofar as the guidance is consistent with the provisions of ERISA.[158]

Liquidity Needs. Ordinarily, an individual account plan — particularly a participant-directed individual account plan — has greater need for liquidity than does a defined benefit plan. Typically, a participant-directed individual account plan allows each a participant to reallocate the participant's account balance among the plan's investment options, to make withdrawals, to borrow from the plan, and to take distributions — creating the possibility that the plan will need to raise cash on any date when such transactions can be effected. By contrast, because a defined benefit plan does not maintain a separate asset-based account for each participant and typically has more predictable needs for cash than does an individual account plan — especially if the defined benefit plan does not permit participants to elect to receive lump-sum benefits — fiduciaries who believe that they can obtain higher long-term returns by making relatively illiquid investments, such as investments in real estate or venture capital companies, might reasonably conclude that they have a greater capacity to make such investments under a defined benefit plan than they do under a participant-directed individual account plan.[159]

Asset Allocation. Typically, under a participant-directed individual account plan, the plan's fiduciaries are not responsible for allocating the plan's assets among the plan's investment options; each participant bears that responsibility with respect to the assets attributable to the participant's account. By contrast, under a defined benefit plan, asset allocation is a major fiduciary responsibility.[160]

Complexity and Number of Investment Options. Participants in a participant-directed individual ac-

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count plan might be overwhelmed or confused if they are presented with too many investment options or investment options that they do not understand. Similar problems do not typically arise under defined benefit plans.[161]

Legal Restrictions. Defined benefit plans are subject to rules that differ from those that apply to individual account plans. For example, EIAPs are exempt from a number of the restrictions on investments in employer stock that apply to defined benefit plans and other non-EIAPs, and the funded status of a defined benefit plan can affect the timing and amount of the benefits that the plan is permitted to distribute.

CONCLUSION

ERISA's duty of prudence governs the conduct of a plan's fiduciaries, not the character of a plan's investments. ERISA does not require employee benefit plans or their fiduciaries to make prudent investments any more than it requires plans or their fiduciaries to make careful, skillful or diligent investments. ERISA's legislative history confirms that Congress intended the duty of prudence to govern fiduciary conduct, not plan investments. The pertinent DOL regulations and the great majority of the courts addressing this subject also confirm that the duty of prudence governs fiduciary conduct, not plan investments. The objectives of ERISA are most effectively advanced if plan fiduciaries are primarily responsible for making investment decisions for the plans they serve. Courts are better equipped to review the conduct of fiduciaries than they are to make investment decisions.

NOTES

[1] Employee Retirement Income Security Act of 1974, as amended (ERISA), 29 USC §§1001 *et seq.*

[2] *Berry v. Ciba-Geigy Corp.*, 761 F.2d 1003, 1006 (4th Cir. 1985); *Johannsen v. District No. 1 — Pacific Coast District, MEBA Pension Plan*, 292 F.3d 159, 169 (4th Cir. 2000) (same). *See Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2350 (2008) (''Nor would we overturn *Firestone* by adopting a rule that in practice could bring about near universal review by judges *de novo* — i.e., without deference — of the lion's share of ERISA plan claims denials. . . . Had Congress intended such a system of review, we believe it would not have left to the courts the development of review standards but would have said more on the subject.''); *id.* at 2353 (''[T]he majority is surely correct in concluding that it is important to retain deferential review for decisions made by conflicted administrators, in order to avoid 'near universal review by judges *de novo*.' '') (Roberts, C.J., concurring in part).

[3] Flip makes *all* investment decisions (including both buy and sell decisions) by flipping a coin. He is not a proxy for the blindfolded, dart-throwing chimpanzee made famous by Burton Malkiel. *See* Burton G. Malkiel, *A Random Walk Down Wall Street* 17 (9th ed. 2007) (''[A] blindfolded chimpanzee throwing darts at the *Wall Street Journal* can select a portfolio that performs as well as those managed by the experts.'').

[4] *See, e.g., Olsen v. Hegarty* , 180 F. Supp. 2d 552, 569 (D.N.J. 2001) (''Just as it is true that the Court may not assume a violation of fiduciary duty based upon evidence of severe losses alone, neither may the Court conclude that these same duties were not violated simply because the Fund did not suffer huge actual losses.''); *Chao v. Moore*, 2001 U.S. Dist. LEXIS 9012 at 11 (D. Md. 6/15/01) (''Much of the Defendants' brief is devoted to heralding the beneficial results of the [limited partnership] purchases. However, the prudent person standard is not concerned with results; rather, it is a test of how the fiduciary acted viewed from the perspective of the time of the [challenged] decision rather than from the vantage point of hindsight'' (citations and internal quotation marks omitted).).

[5] *See Bussian v. RJR Nabisco Inc.*, 223 F.3d 286, 300 (5th Cir. 2000) (The relief sought may affect the availability of a cause of action.). Although ERISA authorizes a court to grant ''appropriate equitable relief,'' the court may grant equitable relief only if it finds that equitable relief is ''appropriate.'' *See* ERISA §502(a)(3) and (5), 29 USC §1132(a)(3) and (5); *Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238, 251 (2000) (''Only a transferee of ill-gotten trust assets may be held liable, and then only when the transferee (assuming he has purchased for value) knew or should have known of the existence of the trust and the circumstances that rendered the transfer in breach of the trust. Translated to the instant context, the transferee must be demonstrated to have had actual or constructive knowledge of the circumstances that rendered the transaction unlawful.'').

[6] *See* ERISA §§4 and 401(a), 29 USC §§1003 and 1101(a).

[7] *See Beck v. PACE Int'l Union*, 551 U.S. 96, 98-99 (2007) (''A defined-benefit plan, as its name implies, is one where the employee, upon retirement, is entitled to a fixed periodic payment. In such a plan, the employer generally shoulders the investment risk. It is the employer who must make up for any deficits, but also the employer who enjoys the fruits (whether in the form of lower plan contributions or sometimes a reversion of assets) if plan investments perform beyond expectations'' (internal quotation marks and citations omitted).); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 440 (1999) (''The structure of a defined benefit plan reflects the risk borne by the employer. . . . Since a decline in the value of a plan's as-

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sets does not alter accrued benefits, members similarly have no entitlement to share in a plan's surplus . . . .''); *Mead Corp. v. Tilley*, 490 U.S. 714, 807-08 (1989) (''§4044(a)(6) does not create benefit entitlements but simply provides for the orderly distribution of plan assets . . . .''); *Johnson v. Georgia-Pacific Corp.*, 19 F.3d 1184, 1188-89 (7th Cir. 1994) (''Defined-benefit plans create claims not just against the assets in the pension trust but against the employer's general assets. Excessive promises of benefits, or poor performance by the assets held in trust, oblige the employer to pay additional sums. . . . A defined-benefit plan gives current and former employees property interests in their pension benefits but not in the assets held by the trust.''). If the plan terminates, however, the participant may (depending on the plan's terms) be entitled to share in any surplus assets that the plan has accumulated. Alternatively, if the plan terminates, the plan is underfunded, and the participant has accrued benefits that are not covered by ERISA's termination insurance program, the participant's benefits may be reduced. *See* ERISA §§4022 and 4044, 29 USC §§1322 and 1344. Moreover, in 2006, Congress amended ERISA to impose restrictions on a defined benefit plan's ability to pay benefits, based on the plan's funded status. *See* Joint Comm. on Tax'n, General Explanation of Tax Legislation Enacted in the 110th Congress, at 569-572 (Mar. 2009) (modifications to funding-related benefit restrictions); Joint Comm. on Tax'n, Technical Explanation of H.R. 4, the ''Pension Protection Act of 2006,'' as passed by the House on July 28, 2006 and as considered by the Senate on Aug. 3, 2006, at 2–41 (8/3/06) (funding-related benefit restrictions).

[8] *See* ERISA §3(34), 29 USC §1002(34).

[9] *See LaRue v. DeWolff, Boberg & Assocs., Inc.*, 128 S. Ct. 1020, 1022 n.1 (2008) (''As its names imply, a 'defined contribution plan' or individual account plan' promises the participant the value of an individual account at retirement, which is largely a function of the amounts contributed to that account and the investment performance of those contributions.'').

[10] The Department of Labor's analysis of the annual reports filed under ERISA for pension plans indicates that in 2006 there were approximately 49,000 defined benefit plans with approximately 20 million active participants and 646,00 individual account plans with approximately 66 million active participants (including approximately 466,000 ''401(k) type'' plans with approximately 58 million active participants, nearly all of whom (approximately 55 million active participants) had investment direction rights over some or all of the assets in their accounts). U.S. Dep't of Labor, Employee Benefits Security Administration, Private Pension Plan Bulletin: Abstract of 2006 Form 5500 Annual Reports, Tables A1 and D6 (Dec. 2008). *See* U.S. Government Accountability Office, Retirement Savings: Automatic Enrollment Shows Promise for Some Workers, but Proposals to Broaden Retirement Savings for Other Workers Could Face Challenges, GAO-10-31, at 3 (Oct. 2009) (''Since the 1980s, defined contribution plans — most prominently the 401(k) plan — have supplanted defined benefit plans as the dominant type of private-sector retirement plan.''); Olivia S. Mitchell and Stephen P. Utkus, ''Lessons from Behavioral Finance for Retirement Plan Design,'' in *Pension Design and Structure: New Lessons from Behavioral Finance* at 3 (Olivia S. Mitchell and Stephen P. Utkus, eds. 2004) (''Participant-directed defined contribution (DC) plans have become the cornerstone of the private-sector retirement system around the world.'').

[11] *See* August J. Baker, Dennis E. Logue and Jack S. Rader, *Managing Pension and Retirement Plans* at 131–144 (2005).

[12] ERISA §3(21)(A), 29 USC §1002(21)(A).

[13] *See* ERISA §§402, 403(a), 405(c), (d), and 503(2), 29 USC §§1102, 1103(a), 1105(c), (d), and 1133(2); DOL Adv. Op. 82-30A (7/7/82).

[14] *See Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996) (''[O]nly when fulfilling certain defined functions, including the exercise of discretionary authority or control over plan management or administration, does a person become a fiduciary . . . .'' (internal quotation marks and citation omitted).); *Varity Corp. v. Howe*, 516 U.S. 489, 502 (1996) (''To decide whether Varity's actions fell within the statutory definition of 'fiduciary' acts, we must interpret the statutory terms which limit the scope of fiduciary activity to discretionary acts of plan 'management' and 'administration' '' (citation omitted).).

[15] ERISA §404(a), 29 USC §1104(a). The duty of loyalty requires a fiduciary to discharge its fiduciary duties solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable plan administration expenses. *Id.* ERISA also requires a fiduciary to diversify the investments of a plan to minimize the risk of large losses unless under the circumstances it is clearly prudent not to do so. ERISA §404(a)(1)(C), 29 USC §1104(a)(1)(C). The Conference Report for ERISA offers the following explanation for the duty to diversify: ''It is not intended that a more stringent standard of prudence be established by the use of the term 'clearly prudent.' Instead, by using this term it is intended that in an action for plan losses based on breach of the diversification requirement, the plaintiff's initial burden will be to demonstrate that there has been a failure to diversify. The defendant then is to have the burden of demonstrating that this failure to diversify was prudent. The substitute places these

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relative burdens on the parties in this matter, because the basic policy is to require diversification, and if diversification on its face does not exist, then the burden of justifying failure to follow this general policy should be on the fiduciary who engages in this conduct.'' H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 304 (1974).

[16] *See* ERISA §§406–407, 29 USC §§1106–1108; *Lockheed Corp. v. Spink*, 517 U.S. 882, 887-88 (1996) (''Sections 404 and 409 of ERISA impose respectively a duty of care with respect to the management of existing trust funds, along with liability for breach of that duty, upon plan fiduciaries. . . . Finally, §406 of ERISA prohibits fiduciaries from involving the plan and its assets in certain kinds of business deals'' (citations omitted).); *Comr. v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 160 (1993) (''Congress' goal was to bar categorically a transaction that was likely to injure the pension plan.'').

[17] *See* ERISA §§3(14), 406(b) and 408(c)(3), 29 USC §§1002(14), 1106(b) and 1108(c)(3).

[18] ERISA §409(a), 29 USC §1109(a). *See, e.g., Martin v. Feilen*, 965 F.2d 660, 672-73 (8th Cir. 1992) (injunctive relief); *Whitfield v. Cohen*, 682 F. Supp. 188, 198-99 (S.D.N.Y. 1988) (same).

[19] *See Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir.), *reh'g denied*, 569 F.3d 708, *pet. for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447). The Seventh Circuit has ruled that ERISA also includes an implied exception for participant-directed individual account plans that do not comply with §404(c). *See Jenkins v. Yager*, 444 F.3d 916, 924 (7th Cir. 2006) (''[W]e agree with the district court and believe that the statute, when read as a whole along with the accompanying regulations, permits a plan trustee to delegate decisions regarding the investment of funds to plan participants even if the plan does not meet the requirements for the section 404(c) safe harbor. Therefore, there is an 'implied exception' to sections 403 and 405 for participant-directed plans, allowing plan participants to direct the investment of their own plan funds.''); *see also Herman v. NationsBank Trust Co. (Georgia)*, 126 F.3d 1354, 1370 (11th Cir. 1997) (''Participants may be named fiduciaries with regard to allocated voted shares — as the Secretary has conceded — because participants have the discretion to decide or the ability to control how those shares should be voted. Participants have control over the allocated shares in their accounts. Participants do not lose control over their shares merely by failing to respond to a tender request, at least not when they are specifically told in the notice that such a response will be treated as a direction not to tender'' (citation omitted).), *reh'g denied*, 135 F.3d 1409 (1998).

[20] 29 CFR §2550.404c-1(d)(2)(i).

[21] 29 CFR §2550.404c-1(b)(3)(i).

[22] *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 444 (1999) (''The . . . act of amending [a plan] . . . does not constitute the action of a fiduciary . . . .'').

[23] *See Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir.) (''We see nothing in the statute that requires plan fiduciaries to include any particular mix of investment vehicles in their plan. . . . That is an issue, it seems to us, that bears more resemblance to the basic structuring of a Plan than to its day-to-day management.), *reh'g denied*, 569 F.3d 708, *pet. for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447).

[24] ERISA §404(a)(1)(D), 29 USC §1104(a)(1)(D) (''[A] fiduciary shall discharge his duties with respect to a plan . . . in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [Titles I and IV of ERISA].''); *cf.* ERISA §403(a), 29 USC §1103(a) (''[T]he trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that . . . the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to the proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act . . . .''); FAB 2004-3 (setting forth the DOL's views on the responsibilities of directed trustees).

[25] *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir.), *reh'g denied*, 569 F.3d 708, 711 (''The Secretary also fears that our opinion could be read as a sweeping statement that any Plan fiduciary can insulate itself from liability by the simple expedient of including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them. She is right to criticize such a strategy. It could result in the inclusion of many investment alternatives that a responsible fiduciary should exclude. It also would place an unreasonable burden on unsophisticated plan participants who do not have the resources to pre-screen investment alternatives. The panel's opinion, however, was not intended to give a green light to such 'obvious, even reckless, imprudence in the selection of investments' (as the Secretary puts it in her brief).''), *pet. for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447).

[26] *See* 57 Fed. Reg. 46906, 46924, n.27 (10/13/92) (''[T]he act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA 404(c) plan is a fiduciary function which, whether achieved through fiduciary designation or express plan language, is not a direct or necessary result of any participant direction of such plan.''); 56 Fed. Reg. 10724, 10732, n.21 (3/13/91) (same); DOL Adv. Op. 98-04A (5/28/98)

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("[T]he act of designating investment alternatives in an ERISA section 404(c) plan is a fiduciary function to which the limitation on liability provided by section 404(c) is not applicable."); DOL Information Letter to Douglas O. Kant (11/26/97) ("The responsible plan fiduciaries are also subject to ERISA's general fiduciary standards in initially choosing or continuing to designate investment alternatives offered by a 404(c) plan. . . . [P]lan fiduciaries have an obligation to prudently select look-through investment vehicles and to periodically evaluate their performance . . . .").

[27] *Compare Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299, 311 (5th Cir. 2007) ("[T]he footnote [in the preamble to the regulation] . . . contradicts the governing statutory language . . . . [and] would render the §404(c) defense applicable only where it is unnecessary."), *with id.* at 320-22 ("The DOL's interpretation of its own §404(c) regulation is reasonable. . . . Further, the majority of courts that have considered the issue have held that . . . the fiduciary retains the duty to prudently select and monitor investment options . . . .") (Reavley, J., dissenting) (citing cases), *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418, n.3 (4th Cir. 2007) ("[T]his safe harbor provision does not apply to a fiduciary's decisions to select and maintain certain investment options within a participant-driven 401(k) plan . . . ."), *In re Tyco Int'l Ltd. Multidistrict Litig.*, 606 F. Supp. 2d 166, 169 (D.N.H. 2009) (following the dissent in *Langbecker*), and *Page v. IMPAC Mortgage Holdings, Inc.*, 2009 U.S. Dist. LEXIS 26992 (C.D. Cal. 3/31/09) (same); *cf. Hecker v. Deere & Co.*, 556 F.3d 575, 589 (7th Cir.) ("Even if §1104(c) does not always shield a fiduciary from an imprudent selection of funds under every circumstance that can be imagined, it does protect a fiduciary that satisfies the criteria of §1104(c) and includes a sufficient range of options so that the participants have control over the risk of loss."), *reh'g denied*, 569 F.3d 708, 710 ("[W]e cannot agree with the Secretary that the footnote in the preamble is entitled to full *Chevron* deference. . . . [W]e left this area open for future development . . . ."), *pet. for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447); *Loomis v. Exelon Corp.,* 2009 U.S. Dist. LEXIS 114626 (N.D. Ill. 12/9/09) (following *Hecker*); *Lingis v. Motorola, Inc.*, 2009 U.S. Dist. LEXIS 50684, at *43-*49 (N.D. Ill. 6/17/09) (following *Hecker*).

[28] ERISA §404(a)(1)(B), 29 USC §1104(a)(1)(B).

[29] *See DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007) ("[A] court must ask whether the fiduciary engaged in a reasoned, decision-making process"); *Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006) ("So long as the prudent person standard is met, ERISA does not impose a duty to take any particular course of action if another approach seems preferable" (citation and internal quotation marks omitted).); *In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 153 (3d Cir. 1999) (ERISA's prudence requirement focuses on "a fiduciary's conduct in arriving at an investment decision, not on its results, and asking whether a fiduciary employed the appropriate methods to investigate *and* determine the merits of a particular investment") (emphasis added, citation and internal quotation marks omitted); *Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, Inc.*, 173 F.3d 313, 317 (5th Cir. 1999) ("The focus of the inquiry is how the fiduciary acted in his selection of the investment, and not whether his investment succeeded or failed") (citation and internal quotation marks omitted).); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983) ("The test of prudence — the Prudent Man Rule — is one of conduct, and not a test of the result of performance of the investment") (citation and internal quotation marks omitted).); *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983) ("Our review of the record convinces us that the district court properly applied the prudent person test. As to each transaction the district court considered whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the transaction and to structure the investment."); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 110-11 (1986) ("A modern paradigm for prudence, then, would shift the focus from the disembodied investment to the fiduciary, the portfolio, and its purpose. . . . [T]he most promising vehicle for accomplishing that shift is a paradigm of prudence based above all on process. Neither the overall performance of the portfolio nor the performance of individual investments should be viewed as central to the inquiry. Prudence should be measured principally by the process through which investment strategies and tactics are developed, adopted, implemented, and monitored. Prudence is demonstrated by the process through which risk is managed rather than by the labeling of specific investment risks as either prudent or imprudent per se.").

[30] *See* ERISA §§407(a) and (b), 408(e), 29 USC §§1107(a) and (b), 1108(e).

[31] *See* ERISA §404(b), 29 USC §1104(b); 29 CFR §2550.404b-1.

[32] 526 F.3d 243, 253-54 (5th Cir. 2008) (citations omitted).

[33] *See Braden v. Wal-Mart Stores, Inc.*, 2009 U.S. App. LEXIS 25810 at *19 (8th Cir. 11/25/09) ("The statute's 'prudent person standard is an objective standard . . . that focuses on the fiduciary's conduct preceding the challenged decision.' . . . In evaluating whether a fiduciary has acted prudently, we therefore focus on the process by which it makes its decisions rather than the results of those decisions" (citations

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and internal quotation marks omitted).); *Cal. Ironworkers Field Pension Trust v. Loomis Sayles & Co.*, 259 F.3d 1036, 1044 (9th Cir. 2001) (upholding district court ruling that fiduciary's use of financial analysis system to assess potential investments was consistent with prevalent industry practice); *Bd. of Trustees of Local 295/Local 851-IBT Empl'r Group Pension Fund v. Callan Assocs. Inc.*, 1999 U.S. App. LEXIS 4364 at *6-*9 (2d Cir. 3/17/99) (acceptable in investment community to effect transition between fixed income managers by liquidating portfolio); *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir. 1984) (''trustees are to be judged according to the standards of others acting in a like capacity and familiar with such matters'') (citation and internal quotation marks omitted); *Donovan v. Mazzola*, 716 F.2d 1226, 1234 (9th Cir. 1983) (''[A]ppellants do not challenge the district court's finding that the Secretary's expert witness correctly stated the prevailing industry standards and that their conduct was deficient because they failed to follow those procedures. . . . [I]n light of the individual appellants' failure to follow accepted standards for hiring a consultant, we agree with the district court's conclusion that the Pension Fund trustees acted imprudently . . . and thereby breached their fiduciary duty under §1104(a)(1)(B) of ERISA.''); *In re Huntington Bancshares Inc. ERISA Litig.*, 620 F. Supp. 2d 842, 851 (S.D. Ohio 2009) (''[T]he plan fiduciaries of large public pension funds (*i.e.,* individuals acting in a like capacity to Defendants), continued to invest in Huntington stock . . . .''); *Ulico Cas. Co. v. Clover Capital Mgmt. Co.*, 335 F. Supp. 2d 335, 340 (N.D.N.Y. 2004) (''This standard requires that the fiduciary's behavior be measured against the standards in the investment industry.''); *U.S. v. Mason Tenders Dist. Council*, 909 F. Supp. 882, 890 (S.D.N.Y. 1995) (''[T]he fiduciary has failed to act as a prudent fiduciary with experience dealing with a similar enterprise'') (citation and internal quotation marks omitted).); *Whitfield v. Cohen*, 682 F. Supp. 188, 194 (S.D.N.Y. 1988) (same); *cf. Wsol v. Fiduciary Mgmt. Assocs., Inc.*, 266 F.3d 654, 656 (7th Cir. 2001) (no loss where plan paid ''standard'' brokerage fees).

[34] *See* S. Rep. No. 127, 93d Cong., 1st Sess. 13 (1973) (''[T]he legislative approach of establishing minimum standards and safeguards for private pensions is not only consistent with retention of the freedom of decision-making vital to pension plans, but in furtherance of the growth and developments of the private pension system.''); *cf. DeBruyne v. Equitable Life Assur. Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) (''[A]ssertions of what a 'typical' balanced fund portfolio manager might have done in 1987 say little about the wisdom of Equitable's investments, only that Equitable might not have followed the crowd.''); *Lanka v. O'Higgins*, 810 F. Supp. 379, 387 (N.D.N.Y. 1992) (Duty of prudence ''requires that the fiduciary's behavior be measured as against the standards in the investment industry.''); *Jones v. O'Higgins*, 1989 U.S. Dist. LEXIS 10537 at *23-*24 (N.D.N.Y. 9/5/89) (''[T]he defendant provided the court with convincing reasons why the contrarian investment strategy he pursued as an ERISA fiduciary were both independently prudent and within the standards and practice in the investment industry. . . . Evidence that the defendant's investments severely diminished the plans' assets over a nine month period does not, in and of itself, show that the 'prudent man' standard has been breached. If, for example, the plaintiff had stayed with the contrarian program he would have received large returns on the investments. Therefore, given the defendant's investment strategy, the maintenance of an investment in declining stocks was prudent.''); *GIW Indus., Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 1989 U.S. Dist. LEXIS 1638 at *16 (S.D. Ga. 2/6/89) (''While custom and practice [in the investment management industry] may enter into a determination of prudence, the particular obligations of a fiduciary under ERISA . . . are not controlled by the investment management industry but by the statute.''); *Chase v. Pevear*, 419 N.E.2d 1358, 1365-1369 (Mass. 1981) (not imprudent to hold widely held securities); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 36 (1986) (critiquing the ''safety in numbers'' doctrine).

[35] *See* Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 82 (1986) (''[S]ince the prudence standard was not intended to be intolerant of those seeking superior performance, it must be defined to accommodate the innovator who proceeds alone but with diligence and informed deliberation.'').

[36] *See Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 10 (1st Cir. 2009) (''State Street engaged in a substantively sound, reasonable analysis of all relevant circumstances appropriate to the decision to sell the . . . stock.''); *Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006) (''[S]o long as the prudent person standard is met, ERISA does not impose a duty to take any particular course of action if another approach seems preferable'' (citation and internal quotation marks omitted).); *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006) (Prudence ''involves a balancing of competing interests under conditions of uncertainty.''); *Hunter v. Caliber Sys., Inc.*, 220 F.3d 702, 722 (6th Cir. 2000) (''The fact that the problem could have been solved by other means does not render [a fiduciary's] decisions imprudent or unreasonable.''); *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 434 (3d Cir. 1996) (''[T]he prudence requirement is flexible, such that the adequacy of a fiduciary's in-

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dependent investigation and ultimate investment selection is evaluated in light of the character and aims of the plan he serves'' (citation and internal quotation marks omitted).); Klevan, ''Fiduciary Responsibility under ERISA's Prudent Man Rule: What Are the Guideposts?'' 44 *J. Tax'n* 152, 153 (Mar. 1976) (intent to allow appropriate distinctions to be made based on employer size and plan characteristics).

[37] *See Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006) (conduct evaluated as of the time the conduct occurred, not ''from the vantage point of hindsight.''); *Cal. Ironworkers Field Pension Trust v. Loomis Sayles & Co.*, 259 F.3d 1036, 1043 (9th Cir. 2001) (''When applying the prudence rule, the primary question is whether the fiduciaries, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment'' (citation and internal quotation marks omitted).); *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 918 (8th Cir. 1994) (The ''test [is] how the fiduciary acted viewed from the perspective of the time of the [challenged] decision rather than from the vantage point of hindsight'' (citation and internal quotation marks omitted).).

[38] *Cf.* Hearings on H.R. 1045, H.R. 1046, and H.R. 16462, Before the General Subcomm. on Labor of the House Comm. on Education and Labor, 91st Cong., 1st and 2d Sess. 476 (1970) (''In recognition of the dynamic character and development of welfare and pension plans, the [prudence provision] attempts to strike a balance between the need for additional safeguards and the desirability of maximum freedom from governmental interference.''); *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 423 (4th Cir. 2007) (''[M]odern portfolio theory has been adopted in the investment community and, for the purposes of ERISA, by the Department of Labor.'').

[39] *See, e.g., Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1097 (9th Cir. 2004) (''A court's task in evaluating a fiduciary's compliance with [the prudence] standard is to inquire whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment'' (citation and internal quotation marks omitted).); *Brock v. Robbins*, 830 F.2d 640, 648 (7th Cir. 1987) (approval of $10 million fee ''after less than ten minutes discussion and without any study . . . is imprudent activity . . . .''); *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982) (''One way for the trustees to inform themselves would have been to solicit the advice of independent counsel . . .''); *Liss v. Smith*, 991 F. Supp. 278, 297 (S.D.N.Y. 1998) (''[W]here the trustees lack the requisite knowledge, experience, and expertise necessary to make the necessary decisions with respect to investments, their fiduciary obligations require them to hire independent professional advisors.''). In addition, because documentation of the fiduciary's decision provides evidence that the fiduciary satisfied the duty of prudence, it is good practice to document such decisions and the reasons for them. *See Henry v. Champlain Enters., Inc.*, 445 F.3d 610, 620 (2d Cir. 2006) (''The focal point of our inquiry under ERISA is not whether a fiduciary took adequate notes of its investigation, but whether it acted with the prudence required of a fiduciary under the prevailing circumstances at the time of the transaction.''); *cf.* Langbein, ''The Uniform Prudent Investor Act and the Future of Trust Investing,'' 81 *Iowa L. Rev.* 641, 662-63 (1996) (predicting courts will give less weight to the ''paper trail'').

[40] *See, e.g., Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 10 (1st Cir. 2009) (''State Street engaged in a substantively sound, reasonable analysis of all relevant circumstances appropriate to the decision to sell the . . . stock.''); *Bussian v. RJR Nabisco, Inc.*, 223 F.3d 286, 300 (5th Cir. 2000) (''[A] fiduciary satisfies ERISA's obligations if, based upon what it learns in its investigation, it selects an annuity provider it reasonably concludes best to promote the interests of participants and beneficiaries'' (citation and internal quotation marks omitted).); *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996) (''[T]he court focuses not only on the merits of the transaction, but also on the thoroughness of the investigation into the merits of the transaction.''); *Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir. 1984) (''Prudence is measured according to the objective 'prudent person' standard developed in the common law of trusts . . . . The court's task is to inquire whether the individual trustees . . . employed the appropriate methods to investigate the merits of the investment and to structure the investment'' (citations and internal quotation marks omitted).); *Whitfield v. Cohen*, 682 F. Supp. 188, 194 (S.D.N.Y. 1988) (''The test of prudence focuses on the trustee's conduct in investigating, evaluating and making the investment.''); *cf. Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 733 (7th Cir. 2006) (''But a discretionary judgment cannot be upheld when discretion has not been exercised.''); *Moench v. Robertson*, 62 F.3d 553, 568 (3d Cir. 1995) ('' 'The court will control the trustee in the exercise of a power where its exercise is left to the judgment of the trustee and he fails to use his judgment' '' (quoting Restatement (Second) of Trusts §187, cmt. h).).

[41] *DeBruyne v. Equitable Life Assur. Soc'y*, 720 F. Supp. 1342, 1349 (N.D. Ill. 1989), *aff'd*, 920 F.2d 457 (7th Cir. 1990).

[42] *DeBruyne v. Equitable Life Assur. Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) (''[T]he ultimate outcome of an investment is not proof of imprudence.'').

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See In re Dell, Inc. ERISA Litig., 563 F. Supp. 2d 681, 694 (W.D. Tex. 2008) (Dell's stock may not have been the best investment. But . . . there is no indication Dell's survival was ever threatened . . . .''); *Olsen v. Hegarty*, 180 F. Supp. 2d 552, 569 (D.N.J. 2001) (''Just as it is true that the Court may not assume a violation of fiduciary duty based upon evidence of severe losses alone, neither may the Court conclude that these same duties were not violated simply because the Fund did not suffer huge actual losses.'').

[43] *See, e.g., Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2350-52 (2008) (conflict of interest more important where circumstances suggest a higher likelihood it affected decision and less important where steps taken to reduce potential bias and to promote accuracy); *Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006) (''[S]o long as the prudent person standard is met, ERISA does not impose a duty to take any particular course of action if another approach seems preferable'' (citation and internal quotation marks omitted).); *Armstrong v. LaSalle Bank Nat'l Ass'n*, 446 F.3d 728, 732-33 (7th Cir. 2006) (''In general, judicial review of the decisions of an ERISA trustee as of other trustees is deferential unless there is a conflict of interest . . . . We must not seat ESOP trustees on a razor's edge. We agree therefore with those courts that review the ESOP trustee's balancing decision deferentially. . . . Even if, as we assumed in *Eyler [v. Comr.*, 88 F.3d 445, 454-456 (7th Cir. 1996)], the general standard of review of an ESOP's decisions for prudence is plenary, a decision that involves a balancing of competing interests under conditions of uncertainty requires an exercise of discretion, and the standard of judicial review of discretionary judgments is abuse of discretion.''); *Flanigan v. Gen. Elec. Co.*, 242 F.3d 78, 86 (2d Cir. 2001) (''[T]he undisputed facts demonstrate that GE employed appropriate methods to investigate and determine the wisdom of the 90-day T-bill investment. . . . This course eliminated the risk that the GE plan trustees would, in the event of a market downturn, have to liquidate substantial additional plan assets . . . . In reaching this decision, it cannot be said that GE or its plan trustees acted irrationally or imprudently.''); *Hunter v. Caliber Sys., Inc.*, 220 F. 3d 702, 722 (6th Cir. 2000) (''The fact that the problem could have been solved by other means does not render [a fiduciary's] decisions imprudent or unreasonable.''); *cf. Caterino v. Barry*, 8 F.3d 878, 883 (1st Cir. 1993) (Breyer, C.J.) (''[W]here, as here, there is no claim of trustee self-dealing or the like, we do not simply substitute our judgment for that of the trustees. We review the trustees' decision at a distance. . . . We cannot say that the trustees' decision here is arbitrary'' (citations and internal quotation marks omitted).); *Brieger v. Tellabs, Inc.*, 629 F. Supp. 2d 848, 860 (N.D. Ill. 2009) (''So long as they do not have a conflict of interest, ERISA trustees are entitled to deferential judicial review.''). *But see In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 154-55 (3d Cir. 1999) (arbitrary and capricious standard of review not applicable to review of prudence claim that does not implicate ERISA's employer stock provisions).

[44] *See Bussian v. RJR Nabisco, Inc.*, 223 F.3d 286, 299 (5th Cir. 2000) (''A fiduciary's duty of care overlaps the duty of loyalty. . . . The presence of conflicting interests imposes on fiduciaries the obligation to take precautions to ensure that their duty of loyalty is not compromised.''); *Leigh v. Engle*, 727 F.2d 113, 132 (7th Cir. 1984) (''The resignation of the interested fiduciary would also have the benefit of obviating in many cases the need for courts to sift through the complicated events surrounding a takeover in an attempt to gauge the prudence and motivations of trustees.''); *Donovan v. Bierwirth*, 680 F.2d 263, 272-73 (2d Cir. 1982) (''We do not mean by this either that trustees confronted with a difficult decision need always engage independent counsel or that engaging such counsel and following their advice will operate as a complete whitewash which, without more, satisfies ERISA's prudence requirement. But this was, and should have been perceived to be, an unusual situation peculiarly requiring legal advice from someone above the battle.''); *cf. LaScala v. Scrufari*, 479 F.3d 213, 221 (2d Cir. 2007) (''Scrufari's actions in giving his son raises without trustee approval, where a prudent person in his position would have known that the trust agreements did not authorize this, violated ERISA §404(a)(1) and ERISA §406(b)(1).'').

[45] *See Metro Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2350-52 (2008) (conflict of interest more important where circumstances suggest a higher likelihood it affected decision and less important where steps taken to reduce potential bias and to promote accuracy); *id.* at 2353 (conflict of interest should be considered only where evidence that it affected decision) (Roberts, C.J., concurring); *Taylor v. United Techs. Corp.*, 2009 U.S. Dist. LEXIS 19059 at *37 (D. Conn. 3/3/09) (''[T]he fact that a fiduciary's action or decision incidentally benefits an employer does not necessarily mean that the fiduciary has breached his duty. . . . The fiduciary must, after careful and impartial investigation, reasonably conclude that the action best promotes the interests of participants and beneficiaries'' (citation and internal quotation marks omitted).), *aff'd per curiam*, 2009 U.S. App. LEXIS 26068 (2d Cir. 12/1/09). As the mere existence of a conflict of interest does not cause a fiduciary to violate ERISA's conflict-of-interest provisions, there is no reason to think that, without an actual effect on the fiduciary's decision, the mere existence of a conflict would cause a fiduciary to violate the duty of pru-

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dence. *See* ERISA §§406(b), 408(c)(3), 29 USC §§1106(b), 1108(c)(3).

[46] An EIAP is an individual account plan that is a profit-sharing, stock bonus, thrift, or savings plan or an ESOP that explicitly provides for the acquisition and holding of employer stock — excluding a plan that is part of a floor-offset arrangement involving a defined benefit plan. *See* ERISA §407(d)(3), 29 USC §1107(d)(3).

[47] An ESOP is a tax-qualified defined contribution plan (i.e., a tax-qualified individual account plan) that is a stock bonus plan, or a stock bonus and a money purchase plan, that is designed to invest primarily in employer stock and that meets certain requirements specified by the Internal Revenue Code (Code) and Treasury Department regulations. *See* Code §4975(e)(7); 26 CFR §54.4975-11.

[48] *See Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003) (''ESOPs . . . are intended to promote the ownership, partial or complete, of firms by their employees.'').

[49] *See* ERISA §§404(a)(2), 407(b), 407(d)(3) and 408(e), 29 USC §§1104(a)(2), 1107(b), 1107(d)(3) and 1108(e).

[50] *See, e.g.,* Code §404(k); *Donovan v. Cunningham*, 716 F.2d 1455, 1458 (5th Cir. 1983).

[51] Tax Reform Act of 1976, P.L. 94-455, §803(h) (''The Congress, in a series of laws . . . has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.'').

[52] *See, e.g., Edgar v. Avaya, Inc.*, 503 F.3d 340, 346-48 (3d Cir. 2007) (''special status of ESOPs''); *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404, 411 (7th Cir. 2006) (''The time may have come to rethink the concept of an ESOP . . .''); *In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *37 (S.D.N.Y. 8/31/09) (recognizing ''Congress's goal of encouraging employee stock ownership'').

[53] *Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995) (quoting the Restatement (Second) of Trusts §227, cmt. g.). *See Edgar v. Avaya, Inc.*, 503 F.3d 340, 346-48 (3d Cir. 2007) (applying the *Moench* presumption to an EIAP that was not an ESOP).

[54] *See Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 256 (5th Cir. 200 8) (''We find in these objections [to the *Moench* presumption] a reenforcement of the conclusion that the *Moench* presumption cannot be lightly overcome.''); *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995) (''We agree with and adopt the Third Circuit's holding [in *Moench*] . . . .''); *Pugh v. Tribune Co.,* 521 F.3d 686, 701 (7th Cir. 2008) (''[P]laintiff 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 comply with the ESOP's direction that he invest exclusively in employer securities'' (citation and internal quotation marks omitted).); *see also Edgar v. Avaya, Inc.*, 503 F.3d 340, 347 (3d Cir. 2007) (applying the *Moench* presumption to EIAPs); *In re RadioShack Corp. ERISA Litig.*, 547 F. Supp. 2d 606, 613 (N.D. Tex. 2008) (following *Edgar*); *In re Harley Davidson, Inc. Sec. Litig.*, 2009 U.S. Dist. LEXIS 94727 at *34-*41 (E.D. Wis. 10/8/09) (following *Pugh*, *Edgar*, and *RadioShack*); *compare Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1098 (9th Cir. 2004) (''Plaintiffs' prudence claim is unavailing under any existing approach. If EIAPs are unconditionally exempt from ERISA's duty to diversify, Defendants' refusal to diversify the Plan beyond the level of 85% clearly does not constitute an actionable violation of ERISA's prudence requirement. If the *Moench* standard controls, Plaintiffs' prudence claim still loses. Unlike *Moench*, this case does not present a situation where a company's financial situation is seriously deteriorating and there is a genuine risk of insider self-dealing'' (footnote omitted).), *with In re Syncor ERISA Litig.*, 516 F.3d 1095, 1102 (9th Cir. 2008) (''[T]his Circuit has not yet adopted the *Moench* presumption, . . . and we decline to do so now'' (citing *Wright*)), *and In re Computer Sciences Corp. ERISA Litig.*, 635 F. Supp. 2d 1128, 1136 (C.D. Cal. 2009) (following *Syncor*); *cf. Lalonde v. Textron, Inc.,* 369 F.3d 1, 6 (1st Cir. 2004) (''[T]he breach of fiduciary duty judgment in favor of the Textron defendants cannot withstand conventional Fed. R. Civ. P. 12(b)(6) scrutiny.'').

[55] 66 F.3d 1447, 1459 (6th Cir. 1995).

[56] *See* Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 83 (1986) (''For the fiduciary, the lesson is that there are no entirely satisfactory formulae to guide investment behavior within the accepted framework of portfolio theory. As informed by that theory, prudence tolerates many alternative strategies while dictating none.'').

[57] *See* Klevan, ''Fiduciary Responsibility under ERISA's Prudent Man Rule: What Are the Guideposts?'' 44 *J. Tax'n* 152, 152–54 (Mar. 1976) (prudence rule intended to be a flexible standard).

[58] *Morrison v. MoneyGram, Inc.,* 607 F. Supp. 2d 1033, 1051-52 (D. Minn. 2009) (''[P]laintiffs' . . .

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contention . . . that the presumption can be overcome merely by showing that a prudent fiduciary would have made a different investment decision . . . would render the presumption meaningless.'').

[59] *Cf. Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan*, 129 S. Ct. 865, 875-76 (2009) (''The Estate's claim therefore stands or falls by the terms of the plan, a straightforward rule of hewing to the directives of the plan documents that lets employers establish a uniform administrative scheme, [with] a set of standard procedures to guide processing of claims and disbursement of benefits. . . . The point is that by giving a plan participant a clear set of instructions for making his own instructions clear, ERISA forecloses any justification for enquiries into nice expressions of intent, in favor of the virtues of adhering to an uncomplicated rule: simple administration, avoid[ing] double liability, and ensur[ing] that beneficiaries get what's coming quickly, without the folderol essential under less-certain rules'' (citation, internal quotation marks, and footnote omitted).).

[60] *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 10 (1st Cir. 2009) (citations omitted); *cf. Stanford v. Foamex L.P.*, 2008 U.S. Dist. LEXIS 63588 (E.D. Pa. 8/20/08) (denying motions to dismiss).

[61] *See, e.g., Edgar v. Avaya, Inc.*, 503 F.3d 340, 346, n.10 (3d Cir. 2007) (In *Moench*, ''we were not concerned with a situation in which an ESOP plan in absolute unmistakable terms requires that the fiduciary invest the assets in the employer's securities regardless of the surrounding circumstances. We explicitly left open the issue of whether there could still be a breach of fiduciary duty in such a case'' (citations and internal quotation marks omitted).); *Moench v. Robertson*, 62 F.3d 553, 567, n.4 (3d Cir. 1995) (same).

[62] *See, e.g., In re Avon Prods., Inc., Sec. Litig.*, 2009 U.S. Dist. LEXIS 32542 at *35-*37 n.22 (S.D.N.Y. 3/3/90) (''In the wake of *Moench*, a number of courts, including the Third Circuit, have suggested a distinction between (1) plans that require the offering of company stock, (2) plans that leave the matter entirely to the discretion of the fiduciaries, and (3) plans that make plain an expectation that company stock will be offered as an investment vehicle. For plans in the first category, even *Moench* recognized that the fiduciary cannot be sued for not diversifying; in the second no presumption applies; in the third category, as in *Moench*, a rebuttable presumption does apply. The submissions in this case make plain that a presumption applies since the Plan document and the Trust Agreement specify the availability of an ESOP. Although the parties do not specifically address these distinctions, the Plan appears to fit within the third category since the documents submitted to us do not explicitly require any specified portion of plan assets to be invested in company shares, and the Trust Agreement contains language that seems to give the fiduciaries some flexibility in offering company stock'' (citations and internal quotation marks omitted).), *adopted*, 2009 U.S. Dist. LEXIS 26507 (S.D.N.Y. 3/30/09); *In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *33 (S.D.N.Y. 8/31/09) (''[I]f an ERISA plan mandates that employer stock be offered as an investment option, plan fiduciaries are required to follow that mandate as long as it is consistent with ERISA's other provisions. At least for EIAPs and ESOPs, investment in employer stock is consistent with ERISA's other provisions, as ERISA explicitly contemplates that EIAPs and ESOPs will invest in employer stock . . . and do so without diversifying.''); *Urban v. Comcast Corp.*, 2008 U.S. Dist. LEXIS 87445 at *33 (E.D. Pa. 10/28/08) (''[W] here a plan's settlor mandates investment in employer securities, the plan fiduciaries are 'immune from judicial inquiry' related to such investments, essentially because they are implementing the intent of the settlor'' (citation omitted).); *Graden v. Conexant Sys., Inc.*, 574 F. Supp. 2d 456, 462 (D.N.J. 2008) (''Where the plan requires investment in a particular stock, the fiduciary's conduct is not subject to judicial review.''); *Smith v. Delta Air Lines, Inc.*, 422 F. Supp. 2d 1310, 1330 (N.D. Ga. 2006) (''*Moench*'s holding defies §1104(a)(2), mandating diversification in certain circumstances even though ERISA plainly excuses it.''); *see also In re Huntington Bancshares, Inc. ERISA Litig.*, 620 F. Supp. 2d 842, 853 (S.D. Ohio 2009) (''ERISA was simply not intended to be a shield from the sometimes volatile financial markets.'').

[63] *See, e.g., Shanehchian v. Macy's, Inc.*, 2009 U.S. Dist. LEXIS 71997 at *12-*13 (S.D. Ohio 8/14/09) (rejecting argument that there is no fiduciary duty to override mandatory plan provisions); *In re Bausch & Lomb, Inc. ERISA Litig.*, 2008 U.S. Dist. LEXIS 106269 at *16-*17 (W.D.N.Y. 12/12/08) (applying *Moench* abuse of discretion standard where plan required plan funds to be invested in employer stock); *In re Coca-Cola Enters. Inc. ERISA Litig.*, 2007 U.S. Dist. LEXIS 44991 at *32 (N.D. Ga. 6/20/07) (''[E] ven if this *Moench* standard were applied, it would still be appropriate only where a company is on the verge of financial collapse.''); *Agway, Inc. Employees' 401(k) Thrift Inv. Plan v. Magnuson*, 2006 U.S. Dist. LEXIS 74670 at *58 (N.D.N.Y. 7/13/06) (''ERISA casts upon fiduciaries an affirmative, overriding obligation to reject plan terms where those terms would require . . . imprudent actions . . . .''); *In re McKesson HBOC, Inc. ERISA Litig.*, 391 F. Supp. 2d 812, 832-33 (N.D. Cal. 2005) (''*Wright* suggests that a plaintiff can only state a claim for a fiduciary's failure to violate the plan and diversify an ESOP by alleging

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that the company faced insolvency. The McKesson Corporation fiduciaries would have violated the Plan if they had diversified the ESOP. . . . [B]ecause plaintiffs' seventh cause of action does not allege that McKesson Corporation faced the prospect of imminent collapse, plaintiffs fail to state a claim.); *In re Polaroid ERISA Litig.*, 362 F. Supp. 2d 461, 474 (S.D.N.Y. 2005) (''[T]o the extent Polaroid stock was an imprudent investment [*sic*], Defendants possessed the authority as a matter of law to exclude Polaroid stock from the ESOP or as a 401(k) investment alternative, regardless of the Plan's dictates.'').

[64] *Kirschbaum v. Reliant Energy, Inc.,* 526 F.3d 243, 255 (5th Cir. 2008) (footnotes omitted).

[65] *Id.* at n.11.

[66] *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir. 1995) (citation and internal quotation marks omitted).

[67] *Edgar v. Avaya, Inc.*, 503 F.3d 340, 345 (3d Cir. 2007); *Moench v. Robertson*, 62 F.3d 553, 567-68 (3d Cir. 1995); *but cf. Lingis v. Motorola, Inc.*, 2009 U.S. Dist. LEXIS 5064 at *49-*50 (N.D. Ill. 6/17/09).

[68] The analysis would be different if the employer stock were not a qualifying employer security, as ERISA does not, in general, allow plan to acquire or hold an employer security that is not a qualifying employer security. *See* ERISA §407, 29 USC §1107.

[69] *See Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 256 (5th Cir. 2008) (''A fiduciary cannot be placed in the untenable position of having to predict the future of the company's stock performance. In such a case, he could be sued for not selling if he adhered to the plan, but also sued for deviating from the plan if the stock rebounded. . . . [I]n some cases, requiring a fiduciary to override the terms of a company stock purchase plan could suggest the necessity of trading on inside information. . . . Moreover, . . . compelling fiduciaries to sell . . . may bring about precisely the result plaintiffs seek to avoid: a drop in the stock price'' (footnote omitted).); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1097, n.4 (9th Cir. 2004) (''Interpreting ERISA's prudence requirement to subject EIAPs to an albeit tempered duty to diversify threatens to eviscerate congressional intent and the guiding rationale behind EIAPs themselves. . . . The *Moench* standard [also] seems problematic to the extent that it inadvertently encourages corporate officers to utilize inside information for the exclusive benefit of the corporation and its employees. Such activities could potentially run afoul of the federal securities laws.''); *In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *41 (S.D.N.Y. 8/31/09) (''[U]nder plaintiffs' interpretation of ERISA, plan fiduciaries could find themselves in a confusing, untenable position, as they would be required to make a perilous choice if the price of employer stock falters.'').

[70] *See* ERISA §404(a)(1)(D), 29 USC §1104(a)(1)(D) (''[A] fiduciary shall discharge his duties with respect to a plan . . . in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [Titles I and IV of ERISA]''.).

[71] *See In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *33-*34 (S.D.N.Y. 8/31/09) (''[I]f an ERISA plan mandates that employer stock be offered as an investment option, plan fiduciaries are required to follow that mandate as long as it is consistent with ERISA's other provisions. At least for EIAPs and ESOPs, investment in employer stock is consistent with ERISA's other provisions, as ERISA explicitly contemplates that EIAPs and ESOPs will invest in employer stock . . . and do so without diversifying. Those textual markers strongly suggest that an EIAP or an ESOP may, consistent with ERISA, *require* that employer stock be offered to participants as an investment option. Such a requirement, therefore, is a plan term that fiduciaries should be compelled to follow'' (citations omitted).); *cf. Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559, 568 (1985) (''[W]e find no inherent inconsistency between ERISA and the interpretation of the trust agreements offered by the . . . trustees.''); *Dardaganis v. Grace Capital Inc.*, 889 F.2d 1237, 1242 (2d Cir. 1989) (The Supreme Court has said that ''absent an 'inherent inconsistency' between a provision in a plan document and a fiduciary duty expressed elsewhere in ERISA, the trustees' assertion of contractual rights pursuant to the plan documents was valid.'').

[72] *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110 (1989).

[73] H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295 (1974).

[74] *Id.* at 302.

[75] *See* H.R. Rep. No. 533, 93d Cong., 1st Sess. 13 (1973) (''The principles of fiduciary conduct are adopted from existing trust law, but with modifications appropriate for employee benefit plans.''); *Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2347 (2008) (''In determining the appropriate standard of review, a court should be guided by principles of trust law . . .'' (citation and internal quotation marks omitted).); *Harris Trust & Sav. Bank v. Salomon Smith Barney Inc.*, 530 U.S. 238, 250 (2000) (''[T]he common law of trusts . . . offers a starting point for analysis [of ERISA] . . . [unless] it is inconsistent with the language of the statute, its structure, or its purposes'' (citation and internal quotation marks omitted).); *Varity Corp. v. Howe*, 516 U.S. 489, 496-97 (1996) (ERISA's ''fiduciary duties draw much of their content from the common law of trusts . . . . [H]owever, . . . trust law does not tell the entire story.'').

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[76] *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996).

[77] *See* Bogert, Bogert and Hess, *The Law of Trusts and Trustees* §612.

[78] Hearings on H.R. 1045, H.R. 1046 and H.R. 16462, Before the General Subcomm. on Labor of the House Comm. on Education and Labor, 91st Cong., 1st and 2d Sess. 477 (1970).

[79] *See Cannon v. Quincy*, 65 Misc. 399, 401-02 (N.Y. Sup. Ct. 1909) (''[T]he law governing investment of trust funds . . . limits a trustee to investment of trust funds in the same kind of securities as those authorized for savings bank investments, and in bonds and mortgages on unincumbered real property in this State to the extent of fifty per cent. of its value. The Banking Law . . . allows savings banks to invest their funds in United States bonds and stocks, State bonds and stocks, bonds and stocks of certain municipalities and first mortgage railroad bonds of certain roads. There is no provision of law by which trust funds may be invested in railroad or industrial stocks.''); *Nagle v. Robins*, 62 P. 154, 159-60 (1900) (''In England and some of the States, the courts have laid down more precise rules, and in the light of experience have dictated the character of securities which a court of equity will deem prudent for a trustee to take. In some of the States the statutes have given directions upon the subject. . . . The English rule forbidding the investment of trust funds in anything but public, or real-estate securities, has been followed in all its strictness, apparently, in the States of New York, New Jersey, and Pennsylvania. But Massachusetts refused to adopt it as inapplicable to the conditions in that State. In Vermont the trustee was held only upon the general rule of good faith, diligence, and care. . . . In New Jersey, in one case, it was said by the chancellor with reference to the policy of adopting the strict English rule, 'I should feel some hesitancy in adopting it to the extent to which it is carried in their courts. The situation of the two countries differs very materially in many respects, and especially as it regards the facility of investments; and what may be a prudent rule of policy in one country may not be in another.' (citation omitted). In some of the States, loans upon personal securities are expressly permitted by statute. In this State the statute does not define specifically the securities which a guardian may take. He is required to manage the estate frugally and without waste. The court may direct and authorize investments in real estate, 'or in any other manner most to the interest of all concerned.' No rule had been laid down by the court of last resort in this State.''); *White v. Sherman*, 168 Ill. 589, 602 (1897) (''Where there are no express directions in the instrument creating the trust, and no statutory provisions, in relation to the character of the securities in which trust funds may be invested, a trustee cannot invest such funds in stocks, bonds or other securities of private business corporations. In England, trustees are required to invest trust funds in real estate securities, or in the public securities of the British government. In this country the same requirement, in regard to making investments in real estate securities or government securities, is generally recognized by the courts. At any rate, 'all speculative risks are forbidden' ''(quoting 2 Pomeroy's Eq. Jur. sec. 1074).); Langbein, ''The Uniform Prudent Investor Act and the Future of Trust Investing,'' 81 *Iowa L. Rev.* 641, 643-44 (1996); Friedman, ''The Dynastic Trust,'' 73 *Yale L.J.* 547, 551-72 (1964); Shattuck, ''The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century,'' 12 *Ohio St. L.J.* 491, 502-04 (1951) (listing states that adopted the ''prudent man rule'' prior to 1940, states that adopted the ''prudent man rule'' by statute after 1940, and states as of 1951 that did not permit trusts to invest in equities in any form).

[80] 26 Mass. (9 Pick.) 446 (1830). *See Rand v. McKittrick*, 346 Mo. 466, 471, 474 (1940) (using a ''prudent man rule'' and rejecting the need to declare certain classes of securities prudent or imprudent); *Scoville v. Brock*, 81 Vt. 405, 419 (1908) (adopting the ''prudent man rule'' and declining to adopt ''special rules determining the classes of securities proper for the investment of trust funds''); *McCoy v. Horwitz*, 62 Md. 183, 189 (1884) (explaining that Maryland had not adopted a legal list statute and that a trustee was to act ''in good faith and without fraud or collusion'').

[81] 26 Mass. (9 Pick.) 446, 461 (1830). *See Sheets v. J.G. Flynt Tobacco Co.*, 195 N.C. 149, 152-53 (1928) (citing *Harvard College*'s prudent man rule); *Peckham v. Newton*, 15 R.I. 321, 322 (1886) (citing *Harvard College* favorably).

[82] Langbein, ''The Uniform Prudent Investor Act and the Future of Trust Investing,'' 81 *Iowa L. Rev.* 641, 644 (1996) (footnotes omitted).

[83] *See Estate of Collins*, 72 Cal. App. 3d 663, 669 (Ct. App. 1977) (''California does not limit the trustee's authority to a list of authorized investments, relying instead on the prudent investor rule.''); Shattuck, ''The Development of the Prudent Man Rule for Fiduciary Investment in the United States in the Twentieth Century,'' 12 *Ohio St. L.J.* 491, 502-04 (1951) (listing states that adopted the ''prudent man rule'' by statute after 1940 (New Hampshire (1941), California (1943), Delaware (1943), Minnesota (1943), Illinois (1945), Maine (1945), Texas (1945), Nevada (1947), Oregon (1947), Washington (1947), Idaho (1949), Kansas (1949), Oklahoma (1949), Utah (1951), and (Colorado 1951)) and states that had adopted the prudent man rule prior to 1940 (Connecticut (1939), Kentucky (1890), Maryland (1884), Massachusetts (1830), Michigan (1937), Missouri (1940), North Carolina (1928), Rhode Island (1886), and Vermont (1908)).

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[84] *See generally* Williams, "The Prudent Man Rule of the Pension Reform Act of 1974," 31 *Bus. Law.* 99, 100 (Oct. 1975); Hearings on H.R. 1045, H.R. 1046 and H.R. 16462, Before the House Comm. on Education and Labor, 91st Cong., 1st and 2d Sess. 773 (1970) (statement of Preston C. Bassett, Council on Employee Benefits) ("[T]he selection of appropriate investments for employee benefit funds should remain decentralized and . . . the establishment of a Federal rule applying to investments should not authorize . . . any . . . agency to lay down highly detailed specifications as to what constitute appropriate investments. . . .").

[85] *See, e.g., In re Bank of New York*, 35 N.Y.2d 512, 517, 364 N.Y.S.2d 164 (1974) ("The record of any individual investment is not to be viewed exclusively, of course, as though it were in its own water-tight compartment, since to some extent individual investment decisions may properly be affected by considerations of the performance of the fund as an entity . . . . The focus of inquiry, however, is nonetheless on the individual security as such and factors relating to the entire portfolio are to be weighed only along with others in reviewing the prudence of the particular investment decisions."); *see generally* Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 16-17 (1986) ("[T]he cry for reform appears to have fallen upon deaf ears."); Pozen, "The Prudent Person Rule and ERISA: A Legal Perspective," *Fin. Analysts J.* 30, 31 (Mar.-Apr. 1977); Williams, The Prudent Man Rule of the Pension Reform Act of 1974, 31 *Bus. Law.* 99, 100 (Oct. 1975).

[86] The evolving nature of ERISA's duty of prudence is consistent with the text of the statute, which refers to "the circumstances then prevailing."

[87] Restatement (Third) of Trusts §90 (2007). *See* Haskell, "The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory," 69 *N.C. L. Rev.* 87, 90, n.17 (1990-91) (citing state statutes (California (1990), Delaware (1974), Georgia (1989), Minnesota (1990), Tennessee (1989), and Washington (1986) supplementing the prudent person rule with statement that decisions are to be judged on basis of portfolio as a whole); *see also* Bogert, Bogert and Hess, *The Law of Trusts and Trustees* §612.

[88] Restatement (Third) of Trusts §90, cmts. a. and b. (2007). *See In re Morgan Guaranty Trust Co.*, 396 N.Y.S.2d 781, 784 (Sup. Ct. 1977) (stating that "prudence is tested at the time of the investment decision, not from the vantage point of hindsight" and that "the test to be applied is one of conduct rather than performance"); *Hartford Nat'l Bank & Trust Co. v. Donahue*, 35 Conn. Supp. 194, 197-98 (Super. Ct. 1979) ("Courts must look at the facts at the time of their occurrence not aided or enlightened by those which subsequently take place. There is no doubt that the test to be applied is one of conduct rather than performance" (internal citation omitted).)

[89] Restatement (Third) of Trusts §90, cmts. f. and g. (2007).

[90] *Id. See Chase v. Pevear*, 383 Mass. 350, 362-64 (1981) (acknowledging the court's adherence to the prudent man standard and explaining that this standard avoids the specification of prudent investments and instead depends on experience; and noting that this court continues to reject the establishment of categories of improper investments); *In re Siegel*, 665 N.Y.S.2d 813, 815 (Surr. Ct. 1997) ("[I]nvestment theory has progressed and, following that, the law governing fiduciary investment standards. The prudent man standard . . ., in effect at the inception of the trust, categorized particular investments, such as certificates of deposit, as prudent. In contrast, the prudent investor standard . . . now in effect judges prudence by reference to risk management and the underlying determination of the appropriate level of risk for a particular portfolio.").

[91] 29 CFR §2550.404a-1.

[92] Preamble, 44 Fed. Reg. 37221, 37222 (6/26/79).

[93] *Id.* The 2006 testimony of Louis Campagna (Chief of the Division of Fiduciary Interpretations of the DOL's Employee Benefits Security Administration), before the Working Group on Prudent Investment Process of the Advisory Council on Employee Welfare and Pension Benefit Plans, was consistent with the preamble to the 1979 regulation: "As to the prudence of monitoring and selecting investments for the Plan, the Trustees must act prudently in selecting investments for the Plan. ERISA does not speak to the prudence of specific investments nor does it characterize any particular investment as being either prudent or imprudent."

[94] *See* Langbein, "The Uniform Prudent Investor Act and the Future of Trust Investing," 81 *Iowa L. Rev.* 641, 642 (1996)

[95] *See id.* at 647 ("[O]ne of the central findings of Modern Portfolio Theory [is] that there are huge and essentially costless gains to diversifying the portfolio thoroughly."); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 32-34 (1986) (ERISA "bears the imprint of modern investment theory far more than do the prudence standards of private trust law. . . . The regulation interpreting ERISA's prudent man standard . . . represents the most sophisticated expression of prudence to have attained the force of law.").

[96] *See DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 423 (4th Cir. 2007) ("[M]odern portfolio theory has been adopted by the investment community and, for purposes of ERISA, by the Department of Labor."); *Laborers Nat'l Pension Fund v. N. Trust Quantitative*

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Advisors, 173 F.3d 313, 322 (5th Cir. 1999) (''In general, the [DOL] regulations provide that the fiduciary shall be required to act as a prudent investment manager under the modern portfolio theory . . . .'').

[97] 29 CFR §2550.404a-4.

[98] *See In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 153-54 (3d Cir. 1999) (upholding district court ruling for defendant-fiduciary on the alternate ground that a hypothetical prudent fiduciary would have made the same investments as the defendant did).

[99] ERISA §§409(a), 502(a), 29 USC §§1109(a), 1132(a).

[100] ERISA §405(a) , 29 USC §1105(a).

[101] *See, e.g., Edgar v. Avaya, Inc.*, 503 F.3d 340, 348 (3d Cir. 2007) (drop in stock price is not conclusive); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1099 (9th Cir. 2004) (same); *DeBruyne v. Equitable Life Assur. Soc'y*, 920 F.2d 457, 465 (7th Cir. 1990) (''We cannot say that Equitable was imprudent merely because the Balanced Fund lost money; such a pronouncement would convert the Balanced Fund into an account with a guaranteed return and would immunize plaintiffs from assuming any of the risk of loss associated with their investment.'').

[102] *See, e.g., Keach v. U.S. Trust Co.*, 313 F. Supp. 2d 818, 873 (C.D. Ill. 2004) (''[E]ven assuming that U.S. Trust had breached a fiduciary duty . . ., U.S. Trust has met its burden of demonstrating that any loss to the ESOP was not caused by any such breach.''), *aff'd*, 419 F.3d 626 (7th Cir. 2005).

[103] *See, e.g., id.* at 863 (''[T]his is not equivalent to a standard of absolute liability, as ERISA fiduciaries are only required to exercise prudence, not prescience or omniscience.'').

[104] 974 F.2d 270 (2d Cir. 1992).

[105] 974 F.3d at 279. *See Sharp Electronics Corp. v. Metro. Life Ins. Co.*, 578 F.3d 505, 512-13 (7th Cir. 2009) (''To survive MetLife's motion to dismiss, Sharp had to include allegations that supported (1) its right of action under ERISA (that is, that Sharp was acting either as a plan fiduciary, beneficiary, or participant); (2) MetLife's status as a plan fiduciary; (3) MetLife's breach of its fiduciary duties; and (4) a cognizable loss to the plan flowing from that breach. See *Pegram v. Herdrich*, 530 U.S. 211, 223-26 (2000); *Jenkins v. Yager*, 444 F.3d 916, 924 (7th Cir. 2006). Sharp's complaint falls short. . . . At no point does Sharp explain how the alleged breach of fiduciary duty imposed (or could have imposed) a loss on the Plan.'').

[106] *See Silverman v. Mut. Benefit Life Ins. Co.*, 138 F.3d 98, 104 (2d Cir. 1998) (''[Plaintiff] must show some causal link between the alleged breach of [the fiduciary's] duties and the loss plaintiff seeks to recover.''); *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994) (''[T]he facts . . . tend to show that the trustees' decision was objectively reasonable regardless of the process by which they reached it and thus that there was no causal connection between their allegedly deficient conduct and a loss to the ESOP. Even if a trustee failed to conduct an investigation before making a decision, he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway.''); *Brock v. Robbins*, 830 F.2d 640, 647 (7th Cir. 1987) (''If trustees act imprudently, but not dishonestly, they should not have to pay a monetary penalty for their imprudent judgment so long as it does not result in a loss to the Fund. . . . While monetarily penalizing an honest but imprudent fiduciary whose actions do not result in a loss to the fund will not further the primary purpose of ERISA, other remedies such as injunctive relief can further the statutory interests.''); *Fink v. Nat'l Sav. & Trust Co.*, 772 F.2d 951, 962 (D.C. Cir. 1985) (Scalia, J. dissenting in part) (''I know of no case in which a trustee who has happened — through prayer, astrology or just blind luck — to make (or hold) objectively prudent investments (e.g., an investment in a highly regarded 'blue chip' stock) has been held liable for losses from those investments because of his failure to investigate and evaluate beforehand.'').

[107] *See LaScala v. Scrufari* , 479 F.3d 213, 221 (2d Cir. 2007) (''The fact that the Funds may not have suffered any loss . . . may bear on the question of damages, but has no bearing on whether Scrufari breached his fiduciary duties in the first place'' (footnote omitted).); *Shaver v. Operating Eng'rs Local 428 Pension Trust Fund*, 332 F.3d 1198, 1203 (9th Cir. 2003) (''Requiring a showing of loss . . . would be to say that the fiduciaries are free to ignore their duties so long as they do no tangible harm, and that the beneficiaries are powerless to rein in the fiduciaries' imprudent behavior until some actual damage has been done. This result is not supported by the language of ERISA, the common law, or common sense.''); *Brock v. Robbins*, 830 F.2d 640, 647 (7th Cir. 1987) (''If the Secretary can prove to a court that certain trustees have acted imprudently, even if there is no monetary loss as a result of the imprudence, then the interests of ERISA are furthered by entering appropriate injunctive relief such as removing the offending trustees from their positions.'').

[108] *See, e.g., Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995) (''[A] fiduciary's failure to investigate an investment decision *alone* is not sufficient to show that the decision was not reasonable. Instead, to show that an investment decision breached a fiduciary's duty to act reasonably in an effort to hold the fiduciary liable for a loss attributable to this investment decision, a plaintiff must show a causal link between the

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failure to investigate and the harm suffered by the plan.''); *Friend v. Sanwa Bank Cal.*, 35 F.3d 466, 469 (9th Cir. 1994) (''ERISA holds a trustee liable for a breach of fiduciary duty only to the extent that losses to the plan result from the breach.''); *In re Citigroup. ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *60-*61 (S.D.N.Y. 8/31/09) (''Since the [fiduciaries] had no discretion to divest the Plans of [employer] stock — and since plaintiffs have not, in any event, overcome the presumption that [employer] stock was a prudent investment [*sic*] — plaintiffs cannot show that a failure to investigate led to any losses to the Plan. . . . Accordingly . . . plaintiffs have failed to state a claim upon which relief can be granted.'').

[109] *See Shaver v. Operating Eng'rs Local 428 Pension Trust Fund*, 332 F.3d 1198, 1203 (9th Cir. 2003) (''Requiring a showing of loss . . . would be to say that the fiduciaries are free to ignore their duties so long as they do no tangible harm, and that the beneficiaries are powerless to rein in the fiduciaries' imprudent behavior until some actual damage has been done. This result is not supported by the language of ERISA, the common law, or common sense.''); *Bussian v. RJR Nabisco, Inc.*, 223 F.3d 286, 300, n.16 (5th Cir. 2000) (''The relief sought may impact whether the hypothetical prudent person standard is appropriate.''); *Brock v. Robbins*, 830 F.2d 640, 647 (7th Cir. 1987) (''If the Secretary can prove to a court that certain trustees have acted imprudently, even if there is no monetary loss as a result of the imprudence, then the interests of ERISA are furthered by entering appropriate injunctive relief such as removing the offending trustees from their positions.'').

[110] 772 F.2d 951 (D.C. Cir. 1985).

[111] As then in effect, ERISA §413(2) provided a three-year statute of limitations for an alleged breach of fiduciary responsibility, measured from ''the earliest date (A) on which the plaintiff had actual knowledge of the breach or violation or (B) on which a report from which he could reasonably be expected to have obtained knowledge of such breach or violation was filed with the Secretary [of Labor] under this title.'' Clause (B) was eliminated by P.L. 100-203, §9343(b).

[112] The majority in *Fink* ruled that a fiduciary's failure to conduct an independent evaluation of a plan investment represented ''a failure to perform the most basic of fiduciary duties,'' that the fiduciary's duty to conduct an independent investigation was ''[o]ver and above its duty to make prudent investments,'' and that the reports filed with the Department of Labor did not disclose the breach of the duty to investigate. 772 F.2d at 957-58.

[113] 223 F.3d 286 (5th Cir. 2000).

[114] 223 F.3d at 300 (internal quotation marks and citations omitted). *See In re Unisys Sav. Plan Litig.*, 173 F.3d 145, 153-54 (3d Cir. 1999) (hypothetical prudent person test); *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994) (same); 29 CFR §2509.95-1 (IB 95-1, selection of annuity providers under defined benefit plans), *amended by* 29 CFR §2550.404a-4 (selection of annuity providers under individual account plans).

[115] *See, e.g., In re Computer Sciences Corp. ERISA Litig.*, 635 F. Supp. 2d 1128, 1139 (C.D. Cal. 2009) (Plaintiffs ''have presented absolutely no evidence that investment in an equally plausible and most appropriate investment alternative would have put the Plan in a better position . . .'' (citation and internal quotation marks omitted).).

[116] The fiduciaries might have any number of other defenses. *See, e.g., LaRue v. DeWolff, Boberg & Assocs., Inc.*, 128 S. Ct. 1020, 1026-28 (2008) (Roberts, C.J., concurring) (claim for benefits); *Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996) (settlor conduct); *Harris v. Amgen, Inc.*, 573 F.3d 728, 732-36 (9th Cir. 2009) (standing); *Kendall v. Employees Ret. Plan of Avon Prods.* , 561 F.3d 112, 120-21 (2d Cir. 2009) (standing); *Hecker v. Deere & Co.*, 556 F.3d 575, 589 (7th Cir.) (§404(c)), *reh'g denied*, 569 F.3d 708, *petition for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447) (ERISA §404(c)); *Edgar v. Avaya, Inc.*, 503 F.3d 340, 350 (3d Cir. 2007) (insider trading); *Caltagirone v. N.Y. Cmty. Bancorp, Inc.*, 2007 U.S. App. LEXIS 29516 at *3-*10 (2d Cir. 12/20/07) (standing); *Jenkins v. Yager*, 444 F.3d 916, 924 (7th Cir. 2006) (implied exception for participant-directed plans); *Brieger v. Tellabs, Inc.*, 629 F. Supp. 2d 848, 867-69 (N.D. Ill. 2009) (statute of limitations); *Shirk v. Fifth Third Bancorp*, 2009 U.S. Dist. LEXIS 90775 (S.D. Ohio 9/30/09) (same); *In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 (S.D.N.Y. 8/31/09) (no discretion); *Brown v. Medtronic, Inc.*, 619 F. Supp. 2d 646, 649-552 (D. Minn. 2009) (standing); *In re Computer Sciences ERISA Litig.*, 635 F. Supp. 2d 1128, 1136-39 (C.D. Cal. 2009) (no loss or loss causation); *Halaris v. Viacom, Inc.*, 2008 U.S. Dist. LEXIS 75557 (N.D. Tex. 8/19/08) (no loss causation); *In re WorldCom, Inc. ERISA Litig.*, 263 F. Supp. 2d 745 (S.D.N.Y. 2003) (not a fiduciary).

[117] *See* 57 Fed. Reg. 46906, 46907, 46922 (10/13/92) (emphasis added); *see also* Klevan, ''Fiduciary Responsibility under ERISA's Prudent Man Rule: What Are the Guideposts?'' *J. Tax'n* 152, 155 (Mar. 1976) (prudence of investment based on role in portfolio).

[118] *See* 72 Fed. Reg. 60452, 60453, 60459, 60462, 60465, 60467, 60476 (10/24/07) (emphasis added).

[119] *See* FAB 2004-3 (emphasis added).

[120] *See* IB 2008-1, 29 CFR §2509.08-1 (emphasis added).

[121] *See* 70 Fed. Reg. 17516, 17533 (4/6/05) (emphasis added).

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[122] *See* Employee Benefits Security Administration, U.S. Department of Labor, ''A Look at 401(k) Plan Fees'' (emphasis added).

[123] *See* Letter to Eugene A. Ludwig, Comptroller of the Currency, from Olena Berg, Assistant Secretary of Labor, Pension and Welfare Benefits Administration (3/21/96) (emphasis added).

[124] *See, e.g., DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418, 423 (4th Cir. 2007) (''[A] fiduciary must initially determine, and continue to monitor, the prudence of *each* investment option available to plan participants. Here, the relevant 'portfolio' that must be prudent is *each* available Fund considered on its own, including the Company [Stock] fund, not the full menu of Plan funds.''); *Evans v. Akers*, 534 F.3d 65, 74 (1st Cir. 2008) (''Losses to a plan from breaches of the duty of prudence may be ascertained . . . by comparing the performance of the imprudent investments with the performance of a prudently invested portfolio.''); *Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299, 308, n.18 (5th Cir. 2007) (''Under ERISA, the prudence of investments or classes of investments offered by a plan must be judged individually.''); *Fink v. Nat'l Sav. & Trust Co.*, 772 F.2d 951, 958 (D.C. Cir. 1985) (''[T]o make prudent investments, the fiduciary has a duty to conduct an independent investigation of the merits of a particular investment.''); *In re Citigroup ERISA Litig.*, 2009 U.S. Dist. LEXIS 78055 at *60 (S.D.N.Y. 8/31/09) (''Since the Administration and Investment Committee had no discretion to divest the Plans of Citigroup stock — and since plaintiffs have not, in any event, overcome the presumption that Citigroup stock was a prudent investment — plaintiffs cannot show that a failure to investigate led to any losses to the Plan.''); *Brieger v. Tellabs, Inc.*, 245 F.R.D. 345, 351 (N.D. Ill. 2007) (''[D]efendants had a fiduciary duty to ensure that each investment choice available to participants was a prudent one.''); *Chao v. Trust Fund Advisors*, 2004 U.S. Dist. LEXIS 4026 at *13 (D.D.C. 1/20/04) (''[W]hile a fiduciary may consider the prudence of an individual investment in the context of the 'whole portfolio,' such consideration does not immunize or permit any individual investment to be less than prudent.''); *In re Polaroid ERISA Litig.*, 362 F. Supp. 2d 461, 474-75 (S.D.N.Y. 2005) ''[T]o the extent Polaroid stock was an imprudent investment, [the plan fiduciaries] possessed the authority as a matter of law to exclude Polaroid stock from the ESOP or as a 401(k) investment alternative, regardless of the Plan's dictates.''); *Tittle v. Enron Corp.*, 284 F. Supp. 2d 511, 668-69 (S.D. Tex. 2003) (The Plan ''seemingly allows complete discretion in how much may be invested in Enron stock where the circumstances make such an investment imprudent.''); *Buccino v. Cont'l Assur. Co.*, 578 F. Supp. 1518, 1521 (S.D.N.Y. 1983) (Defendants ''were under a continuing obligation to advise the Fund to divest itself of unlawful or imprudent investments.''); *cf. Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 248 (5th Cir. 2008) (''Kirschbaum here avers that the REI defendants should have concluded . . . that REI common stock was an imprudent investment.''); *Harley Davidson, Inc. Securities Litig.*, 2009 U.S. Dist. LEXIS 94727 at *18 (E.D. Wisc. 10/8/09) (rejecting claim that ''Harley-Davidson stock was imprudent''); *In re Computer Sciences Corp. ERISA Litig.*, 635 F. Supp. 2d 1128, 1134 (C.D. Cal. 2009) (''Plaintiffs argue that there is 'no genuine disputed issue of material fact that CSC common stock was not a prudent investment for the retirement savings account plan'. . . .''); *Brown v. Medtronic, Inc.*, 619 F. Supp. 2d 646, 650 (D. Minn. 2009) (''Plaintiff claims that Medtronic stock was an imprudent investment . . . .''); *In re First American Corp.*, 2009 U.S. Dist. LEXIS 72188 at *4-*5, *11-*14, *19 and *34 (C.D. Cal. 7/27/09) (allegations that First American stock was not a ''prudent investment''); *Bendaoud v. Hodgson*, 578 F. Supp. 2d 257, 260, 269, and 271–73 (D. Mass. 2008) (claim that employer stock fund was an imprudent investment option); *In re Dell, Inc. ERISA Litig.*, 563 F. Supp. 2d 681, 694 (W.D. Tex. 2008) (''Defendants argue Dell stock was never an imprudent investment despite its fluctuations.''); *In re McKesson HBOC, Inc. ERISA Litig.*, 2002 U.S. Dist. LEXIS 19473 at *38 (N.D. Cal. 9/30/02) (alleged that a directed trustee ''knew, should have known, or is deemed to have known, that [company stock] had become an unsuitable and imprudent investment as a result of . . . improper accounting practices''); Brief of the Secretary of Labor as Amicus Curiae Opposing the Motions to Dismiss, *Tittle v. Enron Corp.*, at 34 (8/30/02) (''[T]he plan's fiduciaries still had fiduciary responsibility for insuring that all of the plan's investments were prudent investments, including the Enron stock.'').

[125] *Kanawi v. Bechtel Corp.*, 590 F. Supp. 2d 1213, 1229 (N.D. Cal. 2008).

[126] *Hecker v. Deere & Co.*, 556 F.3d 575, 589 (7th Cir.), *reh'g denied*, 569 F.3d 708, *petition for cert. filed*, 78 USLW 3239 (U.S. 10/14/09) (No. 09-447) (citation and internal punctuation omitted).

[127] *Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 1117 (C.D. Cal. 2009); *id.* Second Amended Complaint ¶¶69-90, 105R and 105S (4/15/09).

[128] *Id.* at *114 (claim that ''one fund in particular, the T. Rowe Price Science & Technology Fund, was an imprudent investment decision''); *id.* Second Amended Complaint ¶¶105C (4/1/09).

[129] *Id.* at *116-*118; *id.* Second Amended Complaint ¶¶105T and 105N (4/1/09).

[130] *Id.* at *118-*122; *id.* Second Amended Complaint ¶¶91-95, 105Z (4/1/09).

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[131] 2005 U.S. Dist. LEXIS 17503 (N.D. Cal. 7/14/05).

[132] *Id.* at *23.

[133] *Id.* at *24-*25. The district court ruled that even if the plaintiffs' claim could be construed as a diversification claim, the plaintiffs had alleged sufficient facts (regarding JDSU's deteriorating financial condition and the risk of insider self-dealing) to overcome the *Moench* presumption of reasonableness. *Id.* at *25-*26.

[134] *See, e.g., In re Fremont Gen, Corp. Litig.*, 564 F. Supp. 2d 1156, 1159 (C.D. Cal. 2008) (''Defendants knew or should have known that Fremont General was an imprudent investment due to the numerous problems and red flags.'').

[135] 590 F. Supp. 2d 883 (E.D. Mich. 2008).

[136] *Id.* at 892-93.

[137] 607 F. Supp. 2d 1033, 1053-54 (D. Minn. 2009) (quoting *Ford Motor*, above; internal citations omitted).

[138] Langbein, ''The Uniform Prudent Investor Act and the Future of Trust Investing,'' 81 *Iowa L. Rev.* 641, 649 (1996) (''The idea that some securities are intrinsically too risky for trust investors collides with the central findings of Modern Portfolio Theory.''); Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 82-83 (1986) (''[I]t is meaningless to discuss in the abstract the prudence of a 'type'' of investment, such as a stock in a new and untried enterprise, or of a technique, such as the writing of put options. . . . Since higher expected returns can only come from exposure to higher risks, the choice of risk depends on one's time horizon, one's cash flow needs, and one's tolerance for volatility. There is a broad, nearly infinite, spectrum of possibilities in establishing economically defensible risk levels. Across the spectrum, it is not possible to find some Plimsoll line where speculation commences, nor is it socially useful for courts or other government bodies to try to do so'' (footnote omitted).).

[139] *DiFelice v. U.S. Airways, Inc.* , 497 F.3d 410, 423-24 (4th Cir. 2007) (footnote omitted). *See* Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 111 (1986) (''Investment products and techniques are essentially neutral; none should be classified prudent or imprudent per se. It is the way in which they are used, and how decisions as to their use are made that should be examined to determine whether the prudence standard has been met.'').

[140] *See In re Unisys Savs. Plan Litig.*, 74 F.3d 420, 439-40 (3d Cir. 1996) (''[T]he investments that other managers made for the Plans in other investment areas had no bearing on the investment choices Unisys made for the Funds it managed. Moreover, plan-wide investments were not available (and it would appear could not be available) to offset losses sustained by the Fixed Income and Insurance Contract funds as a result of Executive Life's failure. Thus, the risk of loss which section 1104(a)(1)(C) aims to minimize was not distributed among the Plans' total holdings; it was, instead, spread only among the GIC Funds' contracts. We, therefore, conclude that under these circumstances, Unisys' satisfaction of the duty to diversify is properly assessed by examining the concentration of Executive Life investments in the Fixed Income and Insurance Contract Funds.''); *Langbecker v. Electronic Data Sys. Corp.*, 476 F.3d 299, 308, n.18 (5th Cir. 2007) (''Under ERISA, the prudence of investments [*sic*] or classes of investments [*sic*] offered by a [participant-directed individual account] plan must be judged individually'' (citing *Unisys*).); *Fink v. Nat'l Sav. & Trust Co.*, 772 F.2d 951, 958 (D.C. Cir. 1985) (''[T]o make prudent investments [*sic*], the fiduciary has a duty to conduct an independent investigation of the merits of a particular investment.''); *Brieger v. Tellabs, Inc.*, 245 F.R.D. 345, 351 (N.D. Ill. 2007) (''Modern portfolio theory and its upshot, diversification, do not exhaust the requirements of ERISA prudence, however. Several courts have emphasized that ERISA fiduciaries must assess prudence at the level of individual investment choices available to ERISA plan participants. . . . Rather than a unitary 'ready-made' portfolio that reasonably combined a risky hedge with more conservative investments, Plan participants here . . . faced a choice of how to structure their portfolios from a menu selected by a fiduciary.''). By contrast, the Second Circuit has affirmed the dismissal of a claim under ERISA §404(a)(1)(C) that alleged a failure to diversify ''a few individual funds, rather than the plan as a whole.'' *See Young v. Gen. Motors Inv. Mgmt. Corp.*, 2009 U.S. App. LEXIS 9792 at *4 (2d Cir. 5/6/09).

[141] *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404, 411 (7th Cir. 2006) (emphasis added).

[142] *See* H.R. Rep. No. 533, 93d Cong., 1st Sess. 2 (1973) (The bill was designed, among other things, to ''promote a renewed expansion of private retirement plans and increase the number of participants receiving private retirement benefits.'').

[143] *See* H.R. Rep. No. 779, 93d Cong., 2d Sess. 14-15 (1974) (The committee sought to ''strike a balance between providing meaningful reform and keeping costs within reasonable limits.''); *Kennedy v. Plan Adm'r for DuPont Sav. & Inv. Plan*, 129 S. Ct. 865, 875-76 (2009) (''the virtues of adhering to an uncomplicated rule: simple administration, avoid[ing] double liability, and ensur[ing] that beneficiaries get what's coming quickly without the folderol essential under less-certain rules'' (internal quotation marks and citation omitted)); *Egelhoff v. Egelhoff*, 532 U.S. 141, 150 (2001) (''congressional goal of minimizing

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the administrative and financial burdens on plan administrators — burdens ultimately borne by the beneficiaries'') (citation and internal punctuation omitted)).

[144] *See Metro. Life Ins. Co. v. Glenn*, 128 S. Ct. 2343, 2353 (2008) (''We have long recognized 'the public interest in encouraging the formation of employee benefit plans.' Ensuring that reviewing courts respect the discretionary authority conferred on ERISA fiduciaries encourages employers to provide medical and retirement benefits to their employees through ERISA-governed plans — something they are not required to do'' (internal citations omitted) (Roberts, C.J., concurring in part).).

[145] *See Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 1118-19 (C.D. Cal. 2009) (''The sale of a share of common stock typically does not settle until three days after the sale. . . . With a unitized stock fund, however, the Plan participants are allowed to essentially settle their stock trades within one business day, but as a result, the fund has to carry cash in order to cover those sales. . . . Holding a certain level of cash in the fund instead of investing it in stock, typically leads to some loss in return to the participants. . . . [T]he evidence shows that the fiduciaries monitored the amount of cash [in the Edison Stock Fund] and made adjustments when needed to accommodate the trading needs of the Plan participants.''); *Abbott v. Lockheed Martin Corp.*, 2009 U.S. Dist. LEXIS 26878 at *4 (S.D. Ill. 3/31/09) (''The company stock funds are structured as unitized funds, i.e., each investor owns 'units' of the stock funds rather than actual shares of stock. Unit trades are settled in one day rather than in the three-day settlement period typical of selling stock in open market trading. A portion of the funds' assets are held in cash to provide liquidity for daily processing of fund transfers and withdrawals.''); *Taylor v. United Techs. Corp.*, 2009 U.S. Dist. LEXIS 19059 at *26-*27 (D. Conn. 3/3/09) (UTC ''evaluated and monitored the amount of cash [in the UTC Stock Fund] necessary to cover participant sales without having significant adverse effect upon the Fund returns. . . . The Court finds that UTC engaged in prudent decisionmaking to set the cash amount.''), *aff'd per curiam*, 2009 U.S. App. LEXIS 26068 (2d Cir. 12/1/09). Of course, because cash equivalents entail less risk than equity securities (especially a single equity security), $100 invested in a unitized fund is exposed to less risk than $100 invested entirely in the employer's stock. Consequently, any reduction in the rate of return of a unitized employer stock fund is necessarily accompanied by a reduction in investment risk as well. Criticizing a slightly lower return due to ''cash drag'' while ignoring the reduced exposure to investment risk is economically unsound.

[146] In a third case, the plaintiffs claimed that although participants were told that the cash equivalent reserves in the unitized employer stock funds typically ranged from 1% to 3% of the fund, and could be as high as 10%, the reserves repeatedly exceeded 10%. The court declined to grant summary judgment on the ground that there were factual issues bearing on whether there had been a breach of fiduciary duty. *See Abbot v. Lockheed Martin Corp.*, 2009 U.S. Fist. LEXIS 26878 at *31–*33 (S.D. Ill. 3/31/09).

[147] *Berry v. CIBA-GEIGY Corp.*, 761 F.2d 1003, 1006 (4th Cir. 1985).

[148] *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404, 411 (7th Cir. 2006). The courts might also have decided that the decision to establish a ''unitized'' fund was a ''settlor'' decision that was not subject to ERISA's fiduciary standards.

[149] *See, e.g., LaRue v. DeWolff, Boberg & Assocs., Inc.*, 128 S. Ct. 1020, 1024, n.4 (2008) (common law of trusts ''informs [judicial] interpretation of ERISA fiduciary duties.'').

[150] *See, e.g., In re Estate of Marre*, 114 P.2d 586, 590-91 (Cal. 1941); *Hanford v. Clancy*, 183 A. 272, 272-73 (N.H. 1936).

[151] Restatement (Third) of Trusts §87, cmt. b.

[152] *See Hanford v. Clancy*, 183 A. 271, 272 (N.H. 1936) (If the court concludes that the trustee has abused its discretion, ''the court should take appropriate action to curb the trustee, but [the court] may not exercise discretion for [the trustee].'').

[153] *See DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007) (''In determining whether U.S. Airways has [exercised prudence] here we examine the totality of the circumstances, including, but not limited to: the plan structure and aims . . . .''); *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 6 (1st Cir. 2009) (following *DiFelice*); *Cal. Ironworkers Field Pension Trust v. Loomis Sayles & Co.*, 259 F.3d 1036, 1043–45 (9th Cir. 2001) (fiduciary should consider the plan's needs); *Bussian v. RJR Nabisco Corp.,* 223 F.3d 286, 299 (5th Cir. 2000) (''What the appropriate methods are in a given situation depends on the 'character' and 'aim' of the particular plan and decision at issue and the 'circumstances prevailing' at the time . . . .''); *In re McKesson HBOC, Inc. ERISA Litig.*, 391 F. Supp. 2d 812, 831 n.18 (N.D. Cal. 2005) (''As *Moench* illustrates, the terms of the plan influence what is prudent under the plan.''); *GIW Indus., Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 895 F.2d 729, 732-33 (11th Cir. 1990) (''[E]ven though [the investment manager] investigated market conditions before making its investment decision, it did not employ the proper methods to structure the investment to fit the specific needs of Fund A.''); DOL Adv. Op. 2006-08A (10/3/06) (''[A] fiduciary would not, in the view of the Department, violate their fiduciary duties under sections 403 and 404 solely because the fiduciary

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implements an investment strategy that takes into account the liability obligations of the plan and the risks associated with such liabilities and results in reduced volatility in the plan's funding requirements.'').

[154] *See* August J. Baker, Dennis E. Logue and Jack S. Rader, *Managing Pension and Retirement Plans* 133 (2005) (''Sponsors must first decide whether the assets of a DC plan will be invested by the sponsor or the employees. To the extent that plan assets are to be invested by the sponsor, the responsibilities are similar to DB plan responsibilities, recognizing that the sponsor retains significant responsibility for the consequences of the investment decisions it makes.'').

[155] *See Flanigan v. Gen. Elec. Co.*, 242 F.3d 78, 86 (2d Cir. 2001) (''[T]he undisputed facts demonstrate that GE employed appropriate methods to investigate and determine the wisdom of the 90-day T-Bill investment. . . . This course eliminated the risk that the GE plan trustees would, in the event of a market downturn, have to liquidate substantial additional assets . . . . In reaching this decision, it cannot be said that GE or its plan trustees acted irrationally or imprudently.'').

[156] *See* DOL Adv. Op. 2006-08A (10/3/06) (''[A] fiduciary would not, in the view of the Department, violate their fiduciary duties under sections 403 and 404 solely because the fiduciary implements an investment strategy that takes into account the liability obligations of the plan and the risks associated with such liabilities and results in reduced volatility in the plan's funding requirements.'').

[157] *See DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 423 (4th Cir. 2007) (''[A] fiduciary cannot free himself from his duty to act as a prudent man simply by arguing that other funds, which individuals may or may not elect to combine with a company stock fund, could theoretically, in combination create a prudent portfolio [*sic*]'' (footnote omitted).); cases cited at note 140, above; *cf. Laborers Nat'l Labor Fund v. N. Trust Quantitative Advisors, Inc.* , 173 F.3d 313, 322 (5th Cir. 1999) (''[T]he district court erroneously judged the . . . investment in isolation under the common law standard. . .) (defined benefit plan).

[158] *See* ERISA §404(a)(1)(D), 29 USC §1104(a)(1)(D) (''[A] fiduciary shall discharge his duties with respect to a plan . . . in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [Titles I and IV of ERISA]''.). If the plan covers union-represented employees, any such guidance might be collectively bargained. *See Tibble v. Edison Int'l*, 639 F. Supp. 2d 1074, 1082 (C.D. Cal. 2009) (negotiation of plan amendments).

[159] *See* Bevis Longstreth, *Modern Investment Management and the Prudent Man Rule* 82-83 (1986) (''Since higher expected returns can only come from exposure to higher risks, the choice of risk depends on one's time horizon, one's cash flow needs, and one's tolerance for volatility. There is a broad, nearly infinite, spectrum of possibilities in establishing economically defensible risk levels.'').

[160] *See* August J. Baker, Dennis E. Logue and Jack S. Rader, *Managing Pension and Retirement Plans* 135 (2005) (''Participants [in a participant-directed individual account plan] also need information on the effective asset mix of each fund in which they may invest to maintain an asset allocation (including assets outside the pension plan that is appropriate.''); Russell L. Olson, *The Independent Fiduciary* 66 (1999) (''By far, the most important single decision a [defined benefit] pension fund or endowment fund makes is not the particular managers it selects, but its *asset allocation*.'').

[161] *See* Richard H. Thaler and Cass R. Sunstein, *Nudge* 103–131 (2008); Ning Tang, Olivia S. Mitchell, Gary Mottola and Steve Utkus, The Efficiency of Pension Menus and Individual Portfolio Choice in 401(k) Pensions 13–15 (Univ. of Michigan Retirement Research Center, Working Paper WP-2009-203, 2009); Phil Armour and Mary Daly, Retirement Savings and Decision Errors: Lessons from Behavioral Economics, FRBSF Economic Letter (6/6/08); Sheena Sethi-Iyengar, Gur Huberman, and Wei Jiang, How Much Choice Is Too Much? Contributions to 401(k) Retirement Plans, in *Pension Design and Structure: New Lessons from Behavioral Finance* at 88–91 (Olivia S. Mitchell and Stephen P. Utkus, eds. 2004) (''Other things being equal, every ten funds added were associated with 1.5 to 2 percent drop in participation rate.'').

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