09-3804-cv

UNITED STATES COURT OF APPEALS
for the
SECOND CIRCUIT

IN RE: CITIGROUP ERISA LITIGATION

STEPHEN GRAY, *et al.*,

Lead Plaintiffs-Appellants,

v.

CITIGROUP INC., *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE ERISA INDUSTRY COMMITTEE AND THE AMERICAN BENEFITS COUNCIL AS AMICI CURIAE IN SUPPORT OF APPELLEES

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STATEMENT PURSUANT TO FED. R. APP. P. 26.1

The ERISA Industry Committee and the American Benefits Council have no parent corporations and no publicly held company has any ownership interest in either of them.

/s/

Thomas L. Cubbage III

STATEMENT OF CONSENT TO FILING

The parties have consented to the filing of this *amici curiae* brief.

/s/

Thomas L. Cubbage III

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STATEMENT OF INTEREST OF THE AMICI CURIAE[1]

The ERISA Industry Committee ("ERIC") and the American Benefits Council ("Council") (together, the "Associations") are associations whose members maintain, administer, and provide services to pension and other employee benefit plans governed by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), 29 U.S.C. § 1001 *et seq*. With consent of all parties, the Associations submit this brief as *amici curiae* in support of Appellees.

ERIC is a non-profit corporation representing America's largest private employers. The Council is a broad-based non-profit organization with approximately 300 members, primarily large U.S. employers. The Associations' respective members provide benefits to millions of active and retired workers and their families through employee benefit plans governed by ERISA, including employee stock ownership plans and other programs that invest in employer stock.

The Associations participate as *amici curiae* in cases with the potential for far-reaching effects on employee benefit plan design or administration.[2] This is such a case.

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[1] This brief was not authored in whole or part by any party's counsel, and money was contributed to fund its preparation solely by the *amici* and their members. *See* Loc. R. 29.1(b).

[2] *See LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248, 259 (2008) (Roberts, C.J., concurring) (citing ERIC's *amicus* brief); *Hecker v. Deere & Co.*, (continued…)

SUMMARY OF ARGUMENT

In many statutory provisions, Congress strongly encouraged employee benefit plans that allow employees to invest in their employers' stock. When ERISA's fiduciary duties are applied in the context of plans that provide employees with that opportunity, the objectives of such statutes must be considered.

ERISA mandates a standard of care for plan fiduciaries that takes into account the character of the plan. Given this statutory focus, allegations that employer stock was an "imprudent investment" are misguided. They fail to state a colorable claim that a fiduciary who complied with the plan document by allowing investment in employer stock violated the duty of care. Compliance with a plan document that mandates offering employer stock—as Congress encouraged—does not constitute a discretionary and therefore fiduciary action. Moreover, compliance with the plan document is properly presumed to accord with ERISA's standard of care in almost all circumstances. Consequently, given the allegations in this case, the claims of "imprudence" were properly dismissed.

The ERISA duty of loyalty does not require plan fiduciaries to make disclosures about plan investments such as employer stock. The securities laws

556 F.3d 575, 581 (7th Cir.) (citing ERIC and the Council's *amici* brief), *reh'g denied*, 569 F.3d 708 (7th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

provide the appropriate means for protecting investors (including plan participants) from being misled. Where a comprehensive federal regulatory scheme exists, creating federal common law through ERISA is unwarranted and threatens to undermine goals Congress pursued through other statutes.

Since Congress addressed “strike suits” in the securities law arena, abusive ERISA “stock drop” litigation has become commonplace. Such lawsuits often follow even modest declines in stock prices, and seek to circumvent procedural requirements imposed on securities fraud litigation. ERISA fiduciary duties should not be construed to encourage such lawsuits, which threaten to undermine congressional objectives.

ARGUMENT

In recent years, ERISA "stock drop" lawsuits have become commonplace. After gaining attention as part of litigations concerning Enron and Worldcom, such cases now often occur as tag-alongs to securities fraud lawsuits and can follow even a modest decline in an employer's stock price. An emerging consensus of circuit court decisions and sound legal reasoning—grounded in principles of statutory interpretation, congressional intent, and sound public policy—strongly support affirmance of the District Court's dismissal order.

I. Congress Has Encouraged Plans Allowing Employee Investment in Employer Stock.

ERISA distinguishes between two types of retirement plans: defined contribution plans (also known as individual account plans) and defined benefit plans. A defined contribution plan is a pension plan that provides benefits to a participant based solely on the balance in the bookkeeping account that the plan maintains for the participant. The participant's account reflects his or her interest in contributions to the plan and the participant's share of the plan's investment experience and expenses (and any forfeitures of other participants' accounts). Other pension plans are defined benefit plans; typically, the benefit under such a plan is determined by a formula stated in the plan and is not affected by the plan's investment experience. *See* 29 U.S.C. §§ 1002(34), (35); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 440 (1999). Many employers maintain both individual account plans and defined benefit plans and allow eligible employees to participate in both.

Most private sector retirement plans are individual account plans with cash or deferred arrangements, commonly referred to as 401(k) plans after the relevant provision of the Internal Revenue Code, 26 U.S.C. § 401(k). Many of these plans allow each participant to allocate the participant's account among several designated investment options.

Many individual account plans are Employee Stock Ownership Plans ("ESOPs") or offer an ESOP or other employer stock program as an investment option. At the end of 2007, about twenty million Americans participated in 401(k) plans that provided for investment in employer stock. Jack VanDerhei, *et al.*, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007*, at 5, 26 (2008) (data from a representative set of plans).[3] The widespread inclusion of employer stock as an investment option in individual account plans—often through an ESOP—has enabled millions of employees to share in their employers' success and in many cases to participate, by exercising voting rights, in corporate governance.

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[3] *See* http://www.ebri.org/pdf/briefspdf/EBRI_IB_12a-2008.pdf (last viewed March 25, 2010).

The prevalence of employer stock investment options in individual account plans is not accidental. "Congress, believing employees' ownership of their employer's stock a worthy goal, has encouraged the creation of ESOPs both by giving tax breaks and by waiving the duty ordinarily imposed on trustees by modern trust law (including ERISA […]) to diversify the assets of a pension plan." *Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir. 2003); *Donovan v. Cunningham*, 716 F.2d 1455, 1458 (5th Cir. 1983) (employers were encouraged to establish ESOPs as "a device for expanding the national capital base among employees").

Both ERISA and the Internal Revenue Code encourage employers to offer employer stock funds and exempt employer stock programs from requirements that would otherwise hamper their operation. For example, although ERISA generally requires fiduciaries to "diversify[] the investments of the plan so as to minimize the risk of large losses," 29 U.S.C. § 1104(a)(1)(C), there is an exception for "eligible individual account plans" ("EIAPs"), *id*. § 1104(a)(2). An EIAP is an individual account plan that "explicitly provides for acquisition and holding of qualifying employer securities […]." *Id*. § 1107(d)(3).[4] EIAPs also are exempt from the general requirement that no more than 10% of a plan's assets be invested in employer securities and employer real property. *Id*. § 1107(a), (b).

[4] An ESOP is an EIAP. 29 U.S.C. § 1107(d)(3)(A).

Similarly, although ERISA prohibits most transactions between the plan and the employer, *id*. §§ 1002(14)(C), 1106(a)(1), the statute exempts purchases and sales of employer securities meeting certain conditions, *id*. § 1108(e). ERISA likewise generally prohibits a loan between the plan and the employer, *id*. § 1106(a)(1)(B), but permits an ESOP to borrow from the employer (or from a third party with the benefit of the employer's guarantee) in order to invest in employer stock, *id*. § 1108(b)(3).

The Internal Revenue Code also offers tax incentives for employers to maintain plans that invest in employer stock. *See* 26 U.S.C. § 404(k) (allowing employers to deduct dividends paid on ESOP stock); *id*. § 402(e)(4) (preferential tax treatment for net unrealized appreciation on employer stock distributed from tax-qualified plan); *id*. § 1042 (deferring tax on gain from sale of employer stock to ESOP).[5]

Moreover, Congress has emphasized that employee stock ownership deserves special treatment, by enacting legislation stating that "[t]he Congress is deeply concerned that the objectives sought by this series of laws [promoting

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[5] Occasionally, Congress has offered additional incentives, including tax credits for contributions to an ESOP, *e.g.*, Tax Reduction Act of 1975, Pub. L. 94-12 § 301, Tax Reform Act of 1976, Pub. L. 94-455, § 803, Revenue Act of 1978, Pub. L. 95-600, § 141, and an exclusion from a lender's taxable income of 50% of the interest received on a qualifying loan to finance the acquisition of employer securities by an ESOP, *see* 26 U.S.C. § 133 (repealed).

employee stock ownership] will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans […]." Tax Reform Act of 1976, Pub. L. 94-455, § 803(h), 90 Stat. 1520. As the Seventh Circuit observed, most ESOPs are not "intended to replace traditional pension arrangements […]; they are intended to promote the ownership, partial or complete, of firms by their employees." *Steinman*, 352 F.3d at 1103.

II. The Duty of Prudence Claims Were Properly Dismissed.

A. ERISA Requires Courts to Enforce a Standard of Care, Rather Than to Assess Investments.

Plaintiffs' arguments in this case proceed from a misguided premise: that the complaint could state a colorable claim by alleging that, by 2007, Citigroup stock was an "imprudent investment." ERISA's fiduciary duty provisions focus, however, on the way investment decisions are made, rather than on the characteristics of the investments themselves. The duty of prudence requires a plan 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 and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." ERISA

Section 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).[6] ERISA also requires fiduciaries to discharge their duties "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with [other applicable provisions of the statute]." *Id.* § 1104(a)(1)(D).

By its terms, Section 404(a)(1)(B) establishes an objective test for evaluating the prudence of fiduciaries' conduct. *See Katsaros v. Cody*, 744 F.2d 270, 279 (2d Cir. 1984). That test evaluates conduct under standards prevailing at the time it occurred—not "from the vantage point of hindsight." *Chao v. Merino*, 452 F.3d 174, 182 (2d Cir. 2006).

ERISA's fiduciary standards were intended to accommodate a variety of investments and investment strategies. Congress chose not to impose rigid requirements such as the "legal list" rules that limited permissible trust investments under English law and in some states.[7] Instead, ERISA codified the "prudent man" standard of care. Moreover, in accord with congressional intent, "the prudence requirement is flexible, such that the adequacy of a fiduciary's independent investigation and ultimate investment selection is evaluated in light of the character

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[6] Although Plaintiffs and the Secretary of Labor quote Section 404(a)(1)(B) in their briefs, both omitted its final phrase ("in the conduct […]"). App't Br. at 37; Dep't of Labor ("DOL") Br. at 7.

[7] *See* Howard R. Williams, *The Prudent Man Rule of the Pension Reform Act of 1974*, 31 BUS. LAWYER 99, 100 (1975) (discussing Congress's rejection of the "legal list" rule in favor of the prudent fiduciary standard).

and aims of the particular type of plan he serves." *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 434 (3d Cir. 1996) (internal quotation marks omitted).

Plaintiffs urge this Court to adopt the wrong analysis. They mistakenly challenge the "prudence" of Citigroup stock as an investment, rather than the prudence of the Plans' fiduciaries. Thus, in the first paragraph of Appellants' Brief, Plaintiffs assert that Defendants "breached their fiduciary duties by continuing to make and maintain investment in Citigroup, Inc. […] stock, when it was no longer a prudent Plan investment." App't Br. at 1. This misplaced emphasis on the character of the investment, rather than conduct of fiduciaries, recurs throughout their brief. *Id.* at 8 ("Citigroup stock became an imprudent investment […]."); *id.* at 11 ("the stock was overpriced and an imprudent Plan investment"); *id.* at 44 ("Citigroup stock was an imprudent investment"); *id.* at 48 ("Citigroup stock became an imprudent investment").[8]

This is not a mere question of semantics. The difference between prudent *investors* and prudent *investments* is substantial. ERISA defines and mandates the former, but not the latter. Therefore, allegations about the intrinsic quality of an

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[8] Similar mistaken allegations occur in other cases. *E.g.*, *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 accounts plan'"); *Brown v. Medtronic, Inc.*, 619 F. Supp. 2d 646, 650 (D. Minn. 2009) ("Plaintiff claims that Medtronic stock was an imprudent investment").

investment fail to establish entitlement to relief under ERISA. As discussed below, the principles applied by the District Court in this case are in accord with the proper statutory focus.

B. Requiring Plan Investment in Employer Stock Was a Settlor Function, Not a Fiduciary Function.

ERISA's fiduciary standards do not apply to every employer decision affecting a benefit plan. For example, employers "are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate" employee benefit plans. *Hughes Aircraft*, 525 U.S. at 443. ERISA's fiduciary standards do not apply to plan design decisions undertaken in an employer's capacity as sponsor. *Id*. at 444. The choice to set up an ESOP or other EIAP is a plan design decision. When employers take these or similar actions, "they do not act as fiduciaries, but are analogous to the settlors of a trust." *Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996) (citation omitted).

Because a person is a fiduciary for ERISA purposes "only 'to the extent' that he acts in such a capacity," a threshold question is whether a defendant "was performing a fiduciary function […] when taking the action subject to the complaint." *Pegram v. Herdrich*, 530 U.S. 211, 225-26 (2000). The District Court correctly held that none of the Defendants acted in a fiduciary capacity when, as alleged, they allowed participants in the Citigroup Plans to direct investment of assets in their individual accounts in the Citigroup Common Stock Fund.

Generally, ERISA classifies someone as a fiduciary only if the person possesses or exercises *discretionary* responsibility over the management or administration of a plan, and then only *to the extent* of such responsibility. 29 U.S.C. § 1002(21)(A). Because the Citigroup Plans stipulate that the Citigroup Common Stock Fund "shall be permanently maintained" as an investment option in the Plans, none of the Defendants would have been exercising discretion when allowing participants to invest in that option.

C. The Presumption of Prudence Also Justified Dismissal.

i. The Presumption Addresses the Dilemma Faced by Plan Fiduciaries.

Litigation of this kind places the fiduciaries of EIAPs on the horns of a dilemma. They can be sued if they follow the terms of the plan and allow the plan to continue investing in employer stock; they can be sued if they override the terms of the plan by forbidding the purchase of additional employer stock or liquidating the plan's current holdings of employer stock. Although an employer's stock price might currently be depressed, plan fiduciaries are subject to the risk that the stock price will rebound. As the Seventh Circuit observed in a case involving the trustee of United Airlines' ESOP, "if State Street had sold earlier and the stock had then bounced back, as American Airlines' stock did, State Street might well have been sued by the same plaintiffs […]." *Summers v. State St. Bank & Trust Co.*, 453 F.3d 404, 411 (7th Cir. 2006).

This predicament is illustrated by two cases involving the W.R. Grace & Co. 401(k) plan. In 2004-05, various W.R. Grace employees who had directed that their accounts be allocated to employer stock filed two different lawsuits. The plaintiffs in one case alleged that the plan fiduciaries violated their duties by allowing the plan to invest in the employer stock for too long; the plaintiffs in the other case complained that the fiduciaries caused the plan to sell that stock too soon, before its price increased substantially. *See Evans v. Akers*, 534 F.3d 65, 68 (1st Cir. 2008); *Bunch v. W.R. Grace & Co.*, 555 F.3d 1, 2-3 (1st Cir. 2009).[9]

Cases like *Bunch* not only confirm the wisdom of precluding lawsuits attacking fiduciaries for acting in accordance with plan terms, but also support the alternative basis for affirmance here: a presumption that such fiduciaries act consistently with their ERISA duties when they allow participants to invest in employer stock. *See Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995). When fiduciaries have complied with plan terms to allow investment in the employer's stock, they should be presumed to have acted with the "care, skill, prudence, and diligence" that a prudent man would use in conducting "an enterprise of a like character and with like aims." 29 U.S.C. § 1104(a)(1)(B). Otherwise, fiduciaries become "virtual guarantors of the financial success of the

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[9] *See Evans*, 534 F.3d at 68 (noting that the *Bunch* plaintiffs "asserted a diametrically opposed theory of liability").

[…] plan”—at risk if they permit continued investment in employer stock, and equally at risk if they do not. *Moench*, 62 F.3d at 570 (quoting *Martin v. Feilen*, 965 F.2d 660, 666 (8th Cir. 1992)). This approach has been widely adopted by other courts. *See, e.g.*, *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 256 (5th Cir. 2008); *Pugh v. Tribune Co.*, 521 F.3d 686, 701 (7th Cir. 2008); *Wright v. Or. Metallurgical Corp.*, 360 F.3d 1090, 1098 (9th Cir. 2004); *Kuper v. Iovenko*, 66 F.3d 1447, 1459 (6th Cir. 1995).

The presumption that a plan fiduciary acted with the care of a prudent man charged with conducting “an enterprise of a like character and with like aims,” 29 U.S.C. § 1104(a)(1)(B), when complying with the plan document to allow investment in employer stock should be overcome only by showing such “unforeseen circumstances [as] would defeat or substantially impair the accomplishment of the trust’s purposes.” *Kirschbaum*, 526 F.3d at 256. Although courts have described those circumstances in various ways,[10] this Court should endorse the simple concept that where the employer is plainly in a death spiral,

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[10] For example, the Third Circuit has held that evidence of a “precipitous decline” in the price of the employer’s stock and knowledge of the employer’s “impending collapse” would overcome the presumption. *Moench*, 62 F.3d at 572. In another case, that court opined that the presumption could be overcome by showing a “dire situation” that would so threaten the plan’s investment as to “require defendants to disobey the terms of the Plans.” *Edgar v. Avaya, Inc.*, 503 F.3d 340, 348 (3d Cir. 2007).

adherence to plan terms and to the congressional objective of employee capitalism is futile and the risk that the plan's investment will rebound is *de minimis*. Only in those circumstances may a court infer that the settlor would have preferred the recovery of a fraction of the plan's investment over its complete loss, and only then would the fiduciary not be at risk of causing the plan to forgo a recovery. As the W.R. Grace cases illustrate, however, even dire circumstances do not always result in irrecoverable loss. The Ninth Circuit was clearly correct when holding that "[m]ere stock fluctuations, even those that trend down significantly, are insufficient to establish the requisite imprudence to rebut the *Moench* presumption." *Wright*, 360 F.3d at 1099.

ii. The Presumption Is Properly Considered at the Pleadings Stage.

In considering whether alleged facts in an ERISA stock drop case were sufficient to overcome the presumption that fiduciaries acted prudently, the Third Circuit wrote that it saw "no reason to allow this case to proceed to discovery when, even if the allegations are proven true, [plaintiff] cannot establish that defendants abused their discretion." *Edgar*, 503 F.3d at 349 (footnote omitted). The Ninth Circuit also affirmed a dismissal on the basis that alleged facts were not sufficient to establish entitlement to relief in light of the presumption of prudence. *See Wright*, 360 F.3d at 1098 ("Plaintiffs' alleged facts effectively preclude a claim under *Moench*, eliminating the need for further discovery"); *see also Pugh*, 521 F.3d at 701 (citing *Moench* in affirming dismissal of imprudence claim).

Dismissal at the threshold of allegations that, even if true, would not overcome the presumption of prudence is especially appropriate in light of concerns recently expressed by the Supreme Court. *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (2007). *Twombly* states that when allegations in a complaint could not give rise to a plausible claim of entitlement to relief, "this basic deficiency should […] be exposed at the point of minimum expenditure of time and money by the parties and the court." *Twombly*, 550 U.S. at 557 (internal quotation marks and citations omitted). Requiring plaintiffs to allege plausible grounds for providing relief at the pleading stage "serves the practical purpose of preventing a plaintiff with a largely groundless claim from tak[ing] up the time of a number of other people, with the right to do so representing an *in terrorem* increment of the settlement value." *Id*. at 546 (internal quotation marks and citation omitted).[11]

[11] The First Circuit declined to consider a presumption of prudence at the pleadings stage. *Lalonde v. Textron, Inc.*, 369 F.3d 1, 7 (1st Cir. 2004). In doing so, that court relied (*id.*) upon *Conley v. Gibson*, 355 U.S. 41 (1957). In *Twombly*, the Supreme Court repudiated the standard articulated in *Conley*. *See* 550 U.S. at 563.

Efforts to preclude this Court's consideration of the presumption of prudence by calling it an "evidentiary" presumption are meritless. Whatever label one uses, *Moench* and its progeny establish the standard that must be met by a claim that fiduciaries violated their ERISA duties by allowing the plan to continue to invest in employer stock in accordance with the terms of the plan. Allegations that, if proved, would not meet this standard fail to state a "plausible" claim of entitlement to relief. *Twombly*, 550 U.S. at 556.

iii. The Department of Labor's Contention That the Presumption Is Overcome by Allegations That Employer Stock Was "Overpriced" Is Fundamentally Flawed.

As *amicus*, the Secretary of Labor ("DOL") contends that "there is no rationale for applying the *Moench* presumption where, as here, the fiduciaries allegedly knew or should have known that the stock was artificially overpriced." DOL Br. at 17. The DOL maintains that even if the presumption is recognized, allegations "that the fiduciaries knowingly allowed the plan to purchase overpriced stock" suffice to overcome it. *Id.* Consequently, the DOL maintains that "the fiduciaries had a duty to stop investing in the [Citigroup Common Stock] Fund if they knew, as alleged, that the stock was overpriced and therefore an imprudent investment." *Id.* at 12. These contentions are flawed in several respects.

First, the DOL would impermissibly credit allegations of imprudence that depend on hindsight. *Merino*, 452 F.3d at 182 (prudence cannot be judged with hindsight). The fact that a stock has been "overpriced" can only be known in retrospect after a change in circumstance (*e.g.*, publication of adverse news or a corrective disclosure) causes the stock price to drop. Until and unless that occurs, one cannot say that a plan paid "too much" for publicly-traded securities. *See Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 342-43 (2005). The contention that fiduciaries should allow plan investment in employer stock only when that stock is not going to fall in value would not require fiduciaries to be careful; it would require them to be clairvoyant. *See Rogers v. Baxter Int'l, Inc.*, 521 F.3d 702, 705-06 (7th Cir. 2008) (questioning theories that fiduciaries should block plan investment when employer stock is overpriced and "that pension fiduciaries have a duty to outsmart the stock market").

Second, by focusing on whether the employer stock was "overpriced" when acquired by a plan, the DOL erroneously examines the prudence of the *investment. See* DOL Br. at 12 ("[T]he stock was overpriced and therefore an imprudent investment."). The statute tells us, instead, to consider the "care, skill, prudence, and diligence" of fiduciaries in pursuing the plan's "character and […] aims," 29 U.S.C. § 1104(a)(1)(B)—which include, in the case of ESOPs and other EIAPs, the opportunity for employees to acquire employer stock. The DOL's approach thus misapprehends the duty of prudent conduct. *See* Section II.A.

Third, the DOL contends that fiduciaries must disregard the terms of plan documents and halt plan investment in employer stock whenever they know or should have known that those securities are "overpriced." That course of action is impracticable and futile; it would not protect a plan from incurring an investment loss under such alleged circumstances. The market would certainly react negatively to the news that a plan's fiduciaries suddenly halted investment in the employer's stock. Indeed, market speculation about such an unexplained halt to plan investment in employer stock might be the most harmful event that could occur to the plan's existing investment. Yet a publicly-explained halt, coupled with disclosure of adverse material information, will simply precipitate the stock drop and investment loss that these ERISA lawsuits presume fiduciaries should have prevented. *Cf. Kirschbaum*, 526 F.3d at 256; *Edgar*, 503 F.3d at 350; *Summers*, 453 F.3d at 410.[12]

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[12] Plan fiduciaries who obtain detrimental information cannot protect the plan from loss by disclosing such information solely to participants or by liquidating the plan's employer stock investment without public disclosure. Selective disclosure is forbidden; trading decisions made by fiduciaries on the basis of non-public material information could be deemed unlawful insider trading. 17 CFR § 243.100-243.103 (Regulation FD); *id*. § 240.10b-5 (Rule 10b-5); *Employee Benefit Plans*, SEC Release 33-6188, 1980 WL 29482, at *28 & n.168 (Feb. 1, 1980) (plan sales of employer stock are "subject to the […] antifraud provisions of the 1993 Act," as well as Section 10(b) of the 1934 Act and Rule 10b-5); *see also Kirschbaum*, 526 F.3d at 256 ("Fiduciaries may not trade for the benefit of plan participants based on material information to which the general shareholding (continued…)

Finally, given how easily one could allege that a stock was "overpriced," the DOL position would undermine the presumption altogether. As a recent district court decision correctly observes, "[a]llowing plaintiffs to evade the *Moench* presumption merely by pleading that the stock was artificially inflated for one reason or another would eviscerate the presumption." *Wright v. Medtronic, Inc.*, No. 09-cv-0443 (PJS/AJB), 2010 WL 1027808, at *8 (D. Minn. Mar. 17, 2010).

III. The Duty of Loyalty Claims Were Properly Dismissed.

A. The Duty of Loyalty Does Not Create an Obligation to Make Disclosures About Employer Stock.

ERISA and its implementing regulations enumerate disclosures that must be made to plan participants; Plaintiffs here do not allege that Defendants failed to make those disclosures. Instead, Plaintiffs contend that the fiduciary duty to "discharge […] duties with respect to a plan solely in the interest of the participants and beneficiaries," 29 U.S.C. § 1104(a)(1), requires fiduciaries to fulfill a vague and open-ended duty to disclose "adverse information about the employer or its stock [that] could impact retirement benefit plans […]." App't Br. at 53.

Given ERISA's detailed financial reporting and disclosure requirements, its fiduciary duty provisions should not be interpreted to require different or additional

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public has been denied access."); *accord Harzewski v. Guidant Corp.*, 489 F.3d 799, 807-08 (7th Cir. 2007); *Wright*, 360 F.3d at 1098 n.4.

disclosure obligations.[13] As this Court has observed, it is "inappropriate to infer an unlimited disclosure obligation on the basis of [ERISA's] general provisions that say nothing about disclosure." *Board of Trs. of the CWA/ITU Negotiated Pension Plan v. Weinstein*, 107 F.3d 139, 146-47 (2d Cir. 1997) (citation omitted). While courts engage in a form of common-law rulemaking when interpreting ERISA's fiduciary duty provisions, *see Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996), such judicial rulemaking regarding disclosures about public corporations—a core area of securities law regulation—is unnecessary and inappropriate. "Although Congress expect[ed] courts would develop a federal common law of rights and obligations under ERISA-regulated plans, the scope of permissible judicial innovation is narrower in areas where other federal actors are engaged." *Black & Decker Disability Plan v. Nord*, 538 U.S. 822, 831-32 (2003) (internal quotation marks omitted). Federal common law is foreclosed where Congress has established "a comprehensive regulatory program supervised by an expert administrative agency." *Milwaukee v. Illinois*, 451 U.S. 304, 317 (1981); *see also In re Oswego Barge Corp.*, 664 F.2d 327, 335 (2d Cir. 1981), *reh'g denied*, 673

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[13] Most of ERISA's disclosure provisions are set forth in Part 1 of Title I ("Reporting and Disclosure"). These impose detailed disclosure obligations that focus on information about the plan's terms, administration, and benefits and, for defined benefits plans, the plan's funded status. They do not focus on plan investments.

F.2d 47 (2d Cir. 1982). The Securities Act of 1933 and the Securities Exchange Act of 1934, as modified by Congress and implemented by the SEC, represent such a "comprehensive regulatory program" governing disclosures regarding issuers' stocks. *See Baker v. Kingsley*, 387 F.3d 649, 662 (7th Cir. 2004) (declining "to create a new fiduciary duty" of disclosure because of the risk of "disturbing the carefully delineated corporate disclosure laws").

Plaintiffs' assertion that the duty of loyalty implicitly contains a duty to disclose facts regarding plan investments is based on their misapplication of inapposite cases. In *Varity*, for instance, the Supreme Court held that fiduciaries may not mislead plan participants about plan benefits. *See* 516 U.S. at 506. *Varity* did not concern communications about plan investments, but instead involved communications designed to encourage employees to switch from one benefits platform to another upon accepting jobs with an affiliated company. Similarly, in *Estate of Becker v. Eastman Kodak Co.*, 120 F.3d 5, 8 (2d Cir. 1997), this Court found a duty to convey complete and accurate information to plan beneficiaries, but in the context of communications regarding plan benefits, not plan investments. These cases do not support the proposition that fiduciaries have an ERISA duty to disclose information or correct misrepresentations regarding publicly traded employer stock.

B. Statements in SEC Filings Are Not Made by Persons Acting in the Capacity of Plan Fiduciaries.

The "threshold question" in an action charging breach of fiduciary duty under ERISA is "not whether the actions of some person [...] adversely affected a plan beneficiary's interest, but whether that person was acting as a fiduciary (that is, performing a fiduciary function) when taking the action subject to complaint." *Pegram*, 530 U.S. at 226. In *Varity*, the Supreme Court held that, where an employer/plan administrator makes material misrepresentations regarding its corporate well-being *in a fiduciary capacity*, it may be liable for a breach of fiduciary duty under ERISA. *See* 516 U.S. at 503. In that case, the district court found that misleading communications were made by the company in its capacity as plan administrator, as part of an effort to persuade employees to switch benefit plans. *See id*.[14]

In this case, the District Court correctly held that the filing and dissemination of Citigroup's SEC reporting documents such as Forms 10-Q and 10-K did not constitute the making of statements in a plan fiduciary capacity. Just as a person does not act as a plan fiduciary when making SEC filings, a person

[14] The Supreme Court was careful to instruct in *Varity* that "not all of [a company's] business activities involved plan management or administration," 516 U.S. at 498, and that an employer does not act as a fiduciary merely "because it ma[kes] statements about its expected financial condition or because an ordinary business decision turn[ed] out to have an adverse impact on the plan," *id*. at 505 (internal quotation marks omitted).

does not act as a fiduciary when directing that an employer's SEC filings be incorporated by reference in the plan's Securities Act Section 10(a) prospectus. *See In re Worldcom, Inc.*, 263 F. Supp. 2d 745, 766 n.14 (S.D.N.Y. 2003) (explaining that securities laws require dissemination of Section 10(a) prospectus to participants in plan that allows investment in employer stock). Because incorporating the employer's SEC filings in the Section 10(a) prospectus is required by the securities laws and therefore is not discretionary, the person who directs those filings to be incorporated is not acting as a fiduciary when doing so. *See* 29 U.S.C. § 1002(21). The Fifth Circuit has reached the same conclusion. *Kirschbaum*, 526 F.3d at 257.

IV. ERISA "Stock Drop" Lawsuits Threaten to Undermine Congressional Goals.

A. ERISA Fiduciary Standards Should Not Be Construed in "Stock Drop" Lawsuits in Ways That Circumvent Laws Governing Securities Litigation.

In recent years, ERISA stock drop cases have become a commonplace companion to securities fraud class actions. Few large securities cases lack a companion ERISA case. *See, e.g.*, *Pugh*, 521 F.3d at 692 (citing procedural history of consolidated securities and ERISA class actions); *Feder v. Elec. Data Sys. Corp.*, 429 F.3d 125, 128 (5th Cir. 2005) ("In addition to the suits filed by the securities holders, participants in EDS's retirement savings plans brought related suits alleging on a similar basis violations of [ERISA]”).[15] The allegations in this case are typical of ERISA stock drop cases in focusing on alleged misrepresentations to investors rather than upon the conduct of the Plans' fiduciaries in performing Plan-related functions.

The prevalence of “strike suits” in securities litigation led Congress to enact the Private Securities Litigation Reform Act of 1995 (“PSLRA”), Pub. L. No. 104-67, which included provisions to establish greater judicial control over the management of such cases and to dispose of meritless claims at a threshold stage. PSLRA established heightened pleading standards for plaintiffs bringing fraud or misrepresentation class actions under Rule 10b-5 and the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78u-4(b)(1)(B); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007). It requires that a complaint “state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind”—that is, with requisite knowledge of misleading statements or omissions. 15 U.S.C. § 78u-4(b)(2). PSLRA also provides that discovery in securities fraud cases shall be stayed “during the pendency of any motion to dismiss.” *Id*. § 78u-4(b)(3)(B).

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[15] *See, e.g.*, *In re Lehman Bros. Sec. & ERISA Litig.*, No. 09 MD 2017 (LAK), __ F. Supp. 2d __, 2010 WL 354937 (S.D.N.Y. Feb. 2, 2010) (granting motion to dismiss ERISA claims in consolidated cases); *In re Avon Prods., Inc. Sec. Litig.*, No. 05 Civ. 06803 (LAK), 2009 WL 884687 (S.D.N.Y. Mar. 30, 2009) (same).

Another important provision of PSLRA concerns selection of a lead plaintiff and class counsel. Before PSLRA, securities fraud litigation often featured a race to the courthouse by shareholders and their respective lawyers seeking to become presumptive class representative and counsel. Often, the first plaintiff to file was neither the largest nor the most sophisticated investor.[16] Congress responded by requiring courts to appoint the "most adequate plaintiff" as "lead plaintiff," without regard to order of filing and preferring the person with the largest interest in the relief being sought by the class. *Id*. § 78u-4(a)(3)(B).[17]

Through PSLRA, Congress required certain class actions based on allegedly misleading statements or omissions to be brought under the federal securities laws and to be subject to the procedural requirements discussed above. The courts should not allow one category of investors (those who acquire interests in employer stock through employee benefit plans) to evade those requirements. The

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[16] *See* Elliott J. Weiss & John S. Beckerman, *Let the Money Do the Monitoring: How Institutional Investors Can Reduce Agency Costs in Securities Class Actions*, 104 YALE. L.J. 2053, 2060-62 (1995) (discussing pre-PSLRA dynamics of securities litigation, including the "race to the courthouse").

[17] Congress reinforced its efforts to reform securities litigation through the Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, *codified at* 15 U.S.C. § 78bb(f). In response to the migration of securities litigation to state courts, SLUSA mandated "that such class actions be governed exclusively by federal law." *Spielman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 332 F.3d 116, 123 (2d Cir. 2003) (internal quotation marks omitted).

enactment of SLUSA provides compelling evidence that Congress intended class actions alleging securities fraud to be brought under the federal securities laws and to be subject to the procedural requirements of PSLRA.

The same conclusion is required by ERISA, which prohibits the use of ERISA to "alter, amend [...] or supersede" any other federal law. 29 U.S.C. § 1144(d). Insofar as Plaintiffs contend that ERISA's general fiduciary duty provisions should be construed in ways that would alter or supersede disclosure obligations imposed on corporate insiders by securities laws, that contention should be rejected. In addition, Plaintiffs' effort to establish a low pleading threshold for ERISA stock drop cases should be rejected because, among other reasons, it contravenes Congress's intention to impose heightened pleading requirements on cases premised on misrepresentations or omissions relating to publicly traded securities.

By migrating from Rule 10b-5 cases to ERISA fiduciary duty cases, the plaintiffs' bar evidently sought to circumvent PSLRA's heightened pleading requirements. *See*, *e.g.*, *Pugh*, 521 F.3d at 692 (noting that PSLRA requirements do not apply to ERISA claim); *see also Wright v. Medtronic*, 2010 WL 1027808, at *1 ("In this case, as in similar cases around the country, plaintiffs' attorneys have taken what is essentially a securities-fraud action and pleaded it as an ERISA action in order to avoid the demanding pleading requirements of the [PSLRA].").

Moreover, although district courts may exercise their discretion by staying discovery while dismissal motions are pending in ERISA cases, no statute or rule requires them to do so. Furthermore, a stock drop case is not controlled by large institutional investors; the first-filed plaintiffs, who often responded to publicity generated by the proposed class counsel[18] and who may have small personal stakes in the case, generally become the litigants whose lawyers prosecute the claims.

The foregoing observations are not proffered to support the conclusion that PSLRA supersedes ERISA. These facts should, however, influence how courts construe and apply ERISA's general fiduciary duty standards to the context at hand: claims concerning plan investments in employer securities through ESOPs and other EIAPs. As *Moench* and its progeny demonstrate, those general standards must be construed to avoid undermining the congressional objective of encouraging employers to establish plans fostering employee ownership of employer stock. *See* Section I. Moreover, the imposition of ERISA liability on corporate insiders for alleged misrepresentations or omissions regarding company

[18] *See, e.g.*, "Cohen Milstein Investigates Potential ERISA Violations by Citigroup" (press release of Nov. 16, 2007) (available at http://www.allbusiness.com/legal/legal-services-litigation/5313924-1.html) (last viewed March 25, 2010); *see also* "Keller Rohrback L.L.P. Announces ERISA Investigation Regarding the Advanta Corp. Employee Stock Ownership Plan and the Advanta Corp. Employee Savings Plan" (press release of Oct. 21, 2009) (available at http://www.globenewswire.com/newsroom/news.html?d=176170) (last viewed March 25, 2010).

stock could both create a loophole to PSLRA reforms and threaten potential defendants with incompatible duties under two bodies of substantive law.

In this respect, the decision in *Credit Suisse Securities (USA) LLC v. Billing*, 551 U.S. 264 (2007), is instructive. *Billing* held that the federal securities laws impliedly precluded an antitrust suit alleging unlawful practices in connection with initial public offerings. The Supreme Court rejected the plaintiffs' argument that antitrust claims based on activities closely regulated by the securities law should be allowed because both bodies of law had compatible goals and would prohibit the same conduct. *Id.* at 285. In doing so, the Court expressed concern that obligations and potential liabilities arising from antitrust law were unnecessary and could eventually generate inconsistent requirements. The Court also noted, in a point apposite here, that—

> Congress, in an effort to weed out unmeritorious securities lawsuits, has recently tightened the procedural requirements that plaintiffs must satisfy when they file [securities] suits. *To permit an antitrust lawsuit risks circumventing these requirements by permitting what is essentially a securities complaint in antitrust clothing.*

Id. at 284 (emphasis added).

B. "Stock Drop" Lawsuits Undermine Statutes Encouraging Retirement Savings Plans Generally and Investment in Employer Stock Particularly.

ERISA class action suits against fiduciaries who permit investment in employer stock threatens the employer-sponsored retirement plan system. Plan fiduciaries are at risk of being sued whenever the employer's stock price declines or performs below expectations, even if such downturns are only temporary or reflect market-wide trends. Plan sponsors now question the desirability of continuing to offer employer stock as an investment option under their plans.

Removing employer stock would greatly disappoint the vast majority of employees who highly value having employer stock as an investment option. That outcome also would be inconsistent with Congress's judgment that employee ownership of employer stock is a worthy goal in and of itself, one described as "expanding the national capital base among employees—an effective merger of the roles of capitalist and worker." *Cunningham*, 716 F.2d at 1458.

Reducing the desirability of employer stock programs also poses a more general threat to the employer-sponsored retirement plan system. As the Seventh Circuit noted, in a case where the employer had ceased to offer the disputed pension plan even though the defendants were vindicated on appeal, "[i]t is possible […] for litigation about pension plans to make everyone worse off." *Cooper v. IBM Personal Pension Plan*, 457 F.3d 636, 642 (7th Cir. 2006).

ERISA's goals will be undermined if the statute is misapplied to make retirement plans that invest in employer stock more a source of litigation than of retiree income and employee stakeholding. As the Supreme Court stated, courts must consider "competing congressional purposes, such as Congress' desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit [and pension] plans in the first place." *Varity*, 516 U.S. at 497.

CONCLUSION

The Court should affirm the judgment below.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH FED R. APP. P. 29(d) AND 32(a)(7)(B)

This certifies that the number of words in this brief, not including the corporate disclosure statement, table of contents, table of authorities, and certificates of counsel, is 6,988 words, according to the word count of Microsoft Word 97-2003, the word processing system used to prepare this brief.

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