No. 18-1165

In the Supreme Court of the United States

RETIREMENT PLANS COMMITTEE OF IBM, ET AL.,

Petitioners,

—v—

LARRY W. JANDER, ET AL.,

Respondents.

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

BRIEF OF LAW PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF THE RESPONDENTS

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INTEREST OF THE *AMICI CURIAE*

Amici curiae are legal scholars who write and teach about pension and employee benefits law.[1] One of their primary areas of concern is retirement income security under defined contribution plans which, unlike traditional defined benefit plans, (1) provide no particular level of benefits and (2) require plan participants to bear all investment risk. They are particularly concerned about plans that invest assets in employer securities. The issues in this case are exceptionally important because they potentially affect the retirement income security of millions of plan participants. Unlike the situation in 1974, when the Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq.* ("ERISA") was enacted, most plan participants now have only a defined contribution plan; they do not have a defined benefit plan to provide guaranteed retirement income.

In *amici*'s view, the key issue in this case is not, as Petitioners put it, whether "generalized allegations that a fiduciary should have acted differently" should withstand a motion to dismiss. Instead, *amici* believe the primary issue before the Court is whether the Second Circuit appropriately evaluated the specific allegations in the complaint in light of this Court's

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[1] The parties have filed with the Clerk of the Court blanket letters of consent to the filing of amicus briefs in support of any party. In fulfillment of the requirement of Rule 37.6, *amici* state that no counsel for either party has authored this brief in whole or in part, and that no person or entity, other than *amici* or their counsel, made a monetary contribution to the preparation or submission of this brief.

precedent and the exacting fiduciary obligations that ERISA imposes on Employee Stock Ownership Plan ("ESOP") fiduciaries. In *amici*'s view the Second Circuit articulated a sensible and clearly reasoned application of the governing law. The Second Circuit's reasoning and results can be cogently and effectively applied by future courts. Given the procedural posture of this case, the Court should affirm the decision of the Second Circuit and remand to the district court for further factual development.

The issues before the Court are extraordinarily important to the retirement savings of millions of Americans. According to statistics published by the National Center for Employee Ownership ("NCEO"), roughly 11.4 million Americans participate in ESOPs where the sponsor is a publicly traded company.[2] The NCEO estimates that ESOPs hold $147.9 billion of public company securities.[3]

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[2] NCEO, *Employee Ownership by the Numbers* ("*Employee Ownership*"), https://www.nceo.org/articles/employee-ownership-by-the-numbers#1. An additional 1.8 million Americans participate in private company ESOPs. The marketplace and legal issues that frequently arise regarding private company ESOPs are typically quite different than those affecting public companies. Because those securities are not public traded, transactions are less frequent, and fact intensive questions regarding the process and valuation used in transactions are often the subject of expert testimony. *E.g.*, *Allen v. Greatbanc Trust Co.*, 835 F.3d 670 (7th Cir. 2016); *Martin v. Feilin*, 965 F.2d 660 (8th Cir. 1992).

[3] *See Employee Ownership.*

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- David A. Pratt is a Professor of Law at Albany Law School.
- Paul M. Secunda is a Professor of Law at Marquette University Law School.
- Natalya Shnitser is the David and Pamela Donohue Assistant Professor of Law at Boston College Law School.
- Peter Wiedenbeck is the Joseph H. Zumbalen Professor of the Law of Property at the Washington University School of Law.

Amici hope that their experience and expertise will assist the Court in its consideration of the important questions this case presents.

SUMMARY OF THE ARGUMENT

ERISA imposes significant fiduciary obligations on the trustees and fiduciaries of covered retirement plans, including ESOPs. ERISA's central object was to "protect[] employees' justified expectations of receiving the benefits their employers promise them." *Cent. Laborers' Pension Fund v. Heinz*, 541 U.S. 739, 743 (2004) (citing J. Langbein & B. Wolk, PENSION AND EMPLOYEE BENEFIT LAW 121 (3d ed. 2000)). ERISA requires plan assets to be held in trust, out of reach of the employer (and the employer's creditors). ERISA also imposes exacting fiduciary obligations on plan fiduciaries. 29 U.S.C. § 1104(a)(1). By imposing these duties, ERISA radically reformed America's retirement savings marketplace and transformed almost every aspect of the employee benefits America's private-sector workers receive. ERISA's fiduciary duties are among the highest duties known to law, and are more exacting than the duties imposed upon common law trustees. Of particular relevance here, and as set forth in more detail below, 29 U.S.C. § 1104(a)(1)(B) imposes a heightened duty of prudence, under which a fiduciary's conduct is held up to the standard of an experienced professional in the field, whereas the common law of trusts, by contrast, applies a simple reasonably prudent person standard. In addition, ERISA prohibits exculpatory clauses that would relieve a fiduciary of liability, *see* 29 U.S.C. § 1110(a), and subjects the terms of the trust to the statutory requirements, while the common law of trusts generally permitted exculpatory clauses

and allowed much greater flexibility in defining the duties and obligations of the trustee.[4]

This case involves the application of those duties imposed by ERISA to fiduciaries of defined contribution plans. In a defined contribution plan, "participants' retirement benefits are limited to the value of their own individual investment accounts, which is determined by the market performance of employee and employer contributions, less expenses." *Tibble v. Edison Int'l*, 135 S. Ct. 1823, 1825 (2015). The plan in this case includes an ESOP component, meaning that one of the investment options in the plan was a fund consisting primarily of IBM's stock. Because the plan is a defined contribution plan, the losses to participant accounts caused by the artificial inflation of IBM's stock and the reputational harm resulting from IBM's falsification of its financial data reduced, dollar for dollar, the plan participants' retirement benefits.

In *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 417 (2014) ("*Dudenhoeffer*"), the Court considered the application of ERISA's fiduciary duties to ESOP fiduciaries in light of the securities laws, when an ESOP holds the stock of publicly-traded sponsor companies. In *Dudenhoeffer*, the Court expressly rejected a "presumption of prudence" supporting decisions by ESOP fiduciaries to own and hold employer securities, holding that "the law does not create a special presumption

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4 ERISA also categorically prohibits a plan fiduciary from engaging in certain transactions that are rife with a conflict of interest, *see* 29 U.S.C. § 1106, and imposes both personal liability for prohibited transactions under 29 U.S.C. § 1109, as well as stiff tax penalties under parallel provisions added to the Internal Revenue Code. *See* 26 U.S.C. § 4975.

favoring ESOP fiduciaries." *Id.* at 418. Instead, "the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings." *Id.* at 418-19. Significantly, in reaching that holding, the Court explained that (unlike the common law of trusts), an ERISA fiduciary's obligations cannot be overridden by plan documents. *Id.* at 421-23.

The Court in *Dudenhoeffer* went on to provide guidance about what allegations could suffice to plausibly allege a breach of fiduciary duty by an ESOP fiduciary. The Court required lower courts to employ a "careful, context-specific" review of the allegations in each case, and indicated that, in doing so, the lower courts should look at (1) whether the information the plaintiff claims the fiduciary should have acted upon was publicly available or nonpublic; (2) the alternative action the plaintiffs allege the fiduciary should have taken; and (3) whether the complaint plausibly alleges that a fiduciary in defendant's position "could not have concluded" that the alternative action "would do more harm than good." *Id.* at 427-30.

Petitioner's arguments, if adopted, would create an insurmountable hurdle that would insulate ESOP fiduciaries from the precise fiduciary duties that the Court found applicable in *Dudenhoeffer*. Petitioners, unsatisfied with the test that the Court laid out in *Dudenhoeffer* (and that the Second Circuit carefully applied in this case), effectively ask to Court to overrule *Dudenhoeffer* and adopt a presumption of prudence even stricter than the presumption the Court rejected in *Dudenhoeffer*. As the United States points out in its *Amicus* brief, the Court in *Dudenhoeffer* "plainly

contemplated that there would be *some* 'plausible sheep' to divide from the 'meritless goats.'" Brief for the United States as Amicus Curiae Supporting Neither Party ("Govt. Br.") at 29.

In applying the test mandated by *Dudenhoeffer*, the Second Circuit in this case engaged in a context-specific inquiry of the specific allegations set out in the complaint. Here, the Second Circuit was confronted by allegations that the ESOP plan fiduciaries had "primary responsibility" for disclosing that a business unit of IBM was worth $2 billion, a figure that did not properly reflect the fact that the unit was on track to incur losses of $700 million per year. *Jander v. Ret. Plans Comm. of IBM*, 910 F.3d 620, 623 & 628-29 (2d Cir. 2018). Notably, both the Second Circuit and district court agreed that plaintiff "plausibly alleged a GAAP violation" and "plausibly pled . . . that the Plan fiduciaries were aware" of the business unit's impairment. *Id.* at 20. Plaintiffs also alleged that these failures to disclose caused reputational damage that was exacerbated by the prolonged concealment of the truth, and that a business executive at the time could foresee that it "would reflect badly on the company and undermine faith in its future pronouncements," an allegation supported by economic analysis. *Id.* at 21-22. The Second Circuit also pointed to allegations that the fiduciaries knew eventual disclosure of the overvaluation was inevitable, because the company was actively engaged in attempts to sell the business unit in question. *Id.* at 24-25.

In the face of those specific allegations, the Second Circuit correctly concluded that significant concerns about whether the ESOP's fiduciaries faithfully and

prudently carried out their obligations to the plan warranted further factual development. The Second Circuit's decision is entirely consistent with *Dudenhoeffer*, and carefully addressed not just the context-specific facts, but also the intersection between ERISA and the securities laws. Accordingly, the Court should affirm the Second Circuit's opinion, and remand the case to the district court for further factual development.

ARGUMENT

I. ERISA'S FIDUCIARY DUTIES ARE DEMANDING AND EXTREMELY IMPORTANT FOR DEFINED CONTRIBUTION AND ESOP PLAN PARTICIPANTS.

A. ERISA's Fiduciary Duties Are More Exacting Than Those Imposed on Common Law Trustees, and Cannot Be Modified or Reduced.

At the heart of ERISA's legislative framework are broadly applicable, stringent federal fiduciary standards. ERISA requires that plan assets be held in trust, and imposes strict fiduciary duties on trustees and fiduciaries with any authority or control over the plan's assets in the trust.[5] 29 U.S.C. § 1104(a)(1)(A)-(D). As this Court explained, "[t]o help fulfill ERISA's broadly protective purposes, Congress commodiously imposed fiduciary standards on persons whose actions affect the amount of benefits retirement plan participants will receive." *John Hancock Mut. Life Ins. Co. v. Harris Tr. & Sav.*

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[5] *See* 29 U.S.C. §§ 1002(21), 1102(a).

Bank, 510 U.S. 86, 96 (1993); *see also* 29 U.S.C. § 1001(b). ERISA's fiduciary duties have repeatedly been characterized by the courts of appeal as the "highest known to the law." *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982) (Friendly, J.).[6]

While ERISA's fiduciary duties are derived from the law of trusts, there are crucial differences between ERISA's fiduciary duties and the duties of common law trustees. As the Court explained in *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996), "trust law does not tell the entire story. After all, ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection." Indeed, Congress' adoption of ERISA itself reflected the desire "to offer employees enhanced protection for their benefits." *Id.* at 497.

Accordingly ERISA's fiduciary duties are, in critical respects, more demanding than those imposed by the common law of trusts.[7] The duty of prudence

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[6] *See also Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 598 (8th Cir. 2009); *Chao v. Hall Holding Co.*, 285 F.3d 415, 426 (6th Cir. 2002); *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996); *Tatum v. RJR Pension Inv. Comm.*, 761 F.3d 346, 356 (4th Cir. 2014); *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320, 333 (3d Cir. 2019).

[7] Justice Brennan, concurring in *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 158 n.17 (1985), as well as several courts of appeals, have characterized ERISA's fiduciary duties as "more exacting" than those imposed on common law fiduciaries. *Sinai Hosp. of Baltimore, Inc. v. Nat'l Ben. Fund for Hosp. & Health Care Employees*, 697 F.2d 562, 565 (4th Cir. 1982); *Donovan v. Mazzola*, 716 F.2d 1226, 1231 (9th Cir. 1983); *Useden v. Acker*, 947 F.2d 1563, 1581 (11th Cir. 1991); *Brotherston v. Putnam Investments, LLC*, 907 F.3d 17, 37 (1st Cir. 2018).

under the common law of trusts requires trustees to exercise the care and skill that a person "of ordinary prudence" would use when dealing with their own property. RESTATEMENT (SECOND) OF TRUSTS (1959) § 174 & cmt a.[8] However, "if the trustee has or procures his appointment by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill." *Id.*[9] ERISA, by contrast, imposes a higher standard by default. ERISA defines the prudence standard as that which a prudent man "*acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims*." 29 U.S.C. § 1104(a)(1)(B) (emphasis added). Thus ERISA's prudence requirement "is not that of a prudent layperson but rather that of a prudent fiduciary with experience dealing with a similar enterprise." *Whitfield v. Cohen*, 682 F. Supp. 188, 194 (S.D.N.Y. 1988) (quotations omitted).[10]

Like the common law of trusts, ERISA's duty of loyalty requires a fiduciary to "discharge his duties" to

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[8] This brief cites the RESTATEMENT (SECOND) OF TRUSTS (1959), as opposed to the RESTATEMENT (THIRD) OF TRUSTS (2007), because the SECOND RESTATEMENT was the current version when ERISA was adopted in 1974. As relevant here, however, either version of the Restatement would yield essentially the same results.

[9] RESTATEMENT (SECOND) OF TRUSTS § 174 ("[I]f the trustee has or procures his appointment as trustee by representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill."); Bogert's Trusts and Trustees § 541 ("If a trustee has greater skill, the trustee must use that greater skill . . . .").

[10] *See also Lanka v. O'Higgins*, 810 F. Supp. 379, 387 (N.D.N.Y. 1992) ("This standard requires that the fiduciary's behavior be measured as against the standards in the investment industry.")

the plan "solely in the interest of the participants" and "for the exclusive purpose" of providing benefits and defraying expenses. 29 U.S.C. § 1104(a)(1)(A). While some scholars have criticized the burden imposed on corporate pension fund trustees by the "exclusive purpose" rule,[11] Congress has not elected to lessen the standard.

Unlike the common law of trusts, however, which permitted the settlor to relax and define the trustees' duties, *see*, RESTATEMENT (SECOND) OF TRUSTS §§ 170 *cmt. t*, 222, ERISA expressly prohibits such exculpatory clauses, declaring them "void as against public policy." 29 U.S.C. § 1110(a).[12] At common law a trustee's fiduciary duties could be limited or modified by language in the terms of the trust. *E.g.*, RESTATEMENT (SECOND) OF TRUSTS § 164 & cmt. h (explaining that the "nature and extent" of a trustee's duties generally "are determined by the terms of the trust," and that the default duties, such as prudence and loyalty, apply "in the absence of any provision in the terms of the trust" to the contrary).[13] Thus the common law of trusts

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[11] *E.g.*, John H. Langbein & Daniel R. Fischel, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105 (Fall 1988). *But see* Peter J. Wiedenbeck, *Untrustworthy: ERISA's Eroded Fiduciary Law*, 59 WM. & MARY L. REV. 1107, 1021-22 (2018) (explaining that the Langbein-Fischel critique "has gotten no traction in the courts" in large part because taking account of the employer's interests in an employee benefit plan is inconsistent with ERISA's statutory language).

[12] *See also IT Corp. v. Gen. Am. Life Ins. Co.*, 107 F.3d 1415, 1418 (9th Cir. 1997) ("If an ERISA fiduciary writes words in an instrument exonerating itself of fiduciary responsibility, the words, even if agreed upon, are generally without effect.").

[13] There were limitations on exculpatory provisions at common law, however. Exculpatory provisions could not relieve a fiduciary

relied on the trust documents themselves to define the duties of the trustee in the first instance, and imposed the duties of loyalty and prudence as gap-fillers to the extent the trust document was silent. *Id.*

This crucial difference between ERISA and the law of trusts was at the heart of *Dudenhoeffer*, 573 U.S. 409. The Court in *Dudenhoeffer* explained that "by contrast to the rule at common law, trust documents cannot excuse trustees from their duties under ERISA". *Id.* at 422. Relatedly, while both ERISA and the common law impose duties to follow the terms of the trust, under ERISA that duty is circumscribed to the extent the trust instrument is "consistent with the provisions of [ERISA]." 29 U.S.C. § 1104(a)(1)(D). As the Court explained in *Dudenhoeffer*, this provision "makes clear that the duty of prudence trumps the instructions of a plan document, such as an instruction to invest exclusively in employer stock even if financial goals demand the contrary." *Dudenhoeffer*, 573 U.S. at 421.

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of liability for a breach of trust "committed in bad faith or intentionally or with reckless indifference to the interest of the beneficiary, or of liability for any profit which the trustee has derived from a breach of trust," and exculpatory provisions inserted as a result "of an abuse by the trustee of a fiduciary or confidential relationship to the settlor" were not effective. *Id.* § 222(2)-(3). 29 U.S.C. § 1110, by contrast, is unequivocal, and strictly and expressly forbids any reduction in fiduciary liability.

B. ERISA's Fiduciary Duties Are Critically Important in Defined Contribution Plans, Where Participants' Retirement Benefits Are Defined by the Value of Their Investments at Retirement.

The IBM 401(k) Plus Plan (the "IBM Plan") at issue here, like other defined contribution retirement plans, "provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses . . . which may be allocated to such participant's accounts." 29 U.S.C. § 1002(34).

In traditional single-employer defined benefit pension plans participants are entitled to receive specified payments; typically a monthly sum calculated by a formula based on years of service (or plan participation) and some measure of compensation. Employers must systematically fund, in advance, the defined benefit plan using a prescribed actuarial method, and to the extent the plan lacks resources to make payments, the employer is generally obligated to make up the shortfall. To protect participants in underfunded plans of insolvent or bankrupt employers, defined benefit pensions are also guaranteed by the Pension Benefit Guarantee Corporation (the "PBGC").[14]

In contrast, participants in defined contribution plans like the IBM Plan are entitled to no more at retirement than they have in their accounts when

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[14] The PBGC, however, imposes caps on the amount of benefits a retiree can receive in a month. *E.g.*, PBGC, Maximum Monthly Guarantee Tables, https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee.

they reach retirement age. As noted above, in defined contribution plans, employees' benefits at retirement "are limited to the value of their own individual investment accounts, which is determined by the market performance of employee and employer contributions, less expenses." *Tibble*, 135 S. Ct. at 1825.

As such, ERISA's fiduciary duty to ensure that investment options available to defined contribution plan participants are prudent is especially important in the context of defined contribution plans, because poorly-performing investments reduce dollar-for-dollar (and more, when compounded) the amount of benefits participants will receive at retirement. As this Court explained in *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248, 255-56 (2008), when a fiduciary breaches his fiduciary duties in a defined benefit plan it "will not affect an individual's entitlement" to benefits, but a fiduciary breach in a defined contribution plan "reduce[s] benefits below the amount that participants would otherwise receive."

The IBM Plan includes as an investment option the IBM Company Stock Fund, which tracks the returns of the stock of IBM, the Plan's sponsor. The Fund constitutes an ESOP within the IBM Plan. Often, it is devastating for retirement plan participants when ESOP fiduciaries fail in their duties—creating catastrophic losses undercutting the benefit expectations that ERISA was designed to protect. For example, the collapse of Enron Corp. and WorldCom Inc. in the early 2000s virtually wiped out the retirement savings of many employees, who had invested heavily in employer stock through ESOP components of 401(k)

plans like that in the IBM Plan. *See* Richard A. Oppel Jr., *Employees' Retirement Plan Is a Victim as Enron Tumbles*, N.Y. TIMES (Nov. 22, 2001); Kathy Chen, *WorldCom Retirees' Savings Get Battered by Stock's Slide*, WALL ST. J. (Jul. 23, 2002). ERISA fiduciary breach actions brought by participants in those cases yielded significant relief for the plan participants and seminal opinions that shaped the development of the law in this area. *See In re Enron Corp. Securities, Deriv. & ERISA Litig.*, 284 F. Supp. 2d 511 (S.D. Tex. 2003); *In re WorldCom, Inc.*, 263 F. Supp. 2d 745 (S.D.N.Y. 2003) (Cote, J.). The Enron and WorldCom cases were, moreover, reminiscent of the collapse of the Studebaker-Packard company in 1963, which wiped out over 85% of its employees' pensions and ultimately contributed to the adoption of ERISA in 1974. *See* James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683 (2001).

Citing the Studebaker-Packard catastrophe and other similar corporate pension failures, this Court explained in its first major decision interpreting ERISA, *Nachman Corp. v. Pension Ben. Guar. Corp.*, 446 U.S. 359, 374 & n.22 (1980), that "[o]ne of Congress' central purposes in enacting this complex legislation was to prevent the 'great personal tragedy' suffered by employees whose vested benefits are not paid when pension plans are terminated." The losses suffered by participants in the IBM ESOP, even if smaller in magnitude, were no less real nor less a "great personal tragedy" than the losses suffered by the participants in the Enron and WorldCom plans, or the losses suffered by pensioners at Studebaker-Packard and

similar companies before 1974. While the Studebaker-Packard collapse involved a traditional defined benefit plan, and not a defined contribution plan, as an economic matter participants in an unfunded defined benefit plan whose employer was insolvent (prior to the adoption of ERISA and PBGC coverage) are in virtually the same position as participants in a modern defined contribution plan that hold employer securities when their employer is insolvent.[15] It should, accordingly, come as no surprise that the extraordinarily strict fiduciary duties imposed by ERISA sometimes put insider fiduciaries in a very difficult position.

II. PETITIONERS' ARGUMENTS ABOUT THE DUTIES OF INSIDER ESOP FIDUCIARIES ARE INCONSISTENT WITH *DUDENHOEFFER.*

A. Under *Dudenhoeffer*, ESOP Fiduciaries Generally Remain Subject to ERISA's Fiduciary Duties.

This is not the first case in which this Court has been confronted with the application of ERISA's fiduciary duties to defined contribution plans containing an ESOP component. In *Dudenhoeffer*, 573 U.S. at 412, the Court ruled that "ESOP fiduciaries are subject to the same duty of prudence that applies to ERISA fiduciaries in general . . . ."

In *Dudenhoeffer*, the fiduciaries argued that, based on Congress' goal of promoting ESOPs, ERISA's

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[15] To be specific, participants with unfunded uninsured accrued benefits under a traditional pension plan (as in Studebaker) have the status of unsecured general creditors, while ESOP participants, as stockholders with residual claims, take no priority whatsoever.

ordinary fiduciary duties should give way to a "presumption of prudence" in favor of holding employer securities in ESOPs. The Court rejected that argument, noting that ERISA expressly exempts ESOP fiduciaries *only* from ERISA's duty to diversify plan assets. *Id.* at 422. The Court held that Congress sought to promote ESOPs by "exempting ESOPs from ERISA's diversification requirement, which otherwise would have precluded their creation," but cautioned that "we are not convinced that Congress *also* sought to promote ESOPs by further relaxing the duty of prudence," with, for example, a presumption of prudence. *Id.*

While recognizing that encouraging employee stock ownership was one of ERISA's goals, the Court explained that the ESOP-promotion goal was subsidiary to ERISA's primary goal of protecting retirement savings, and that considerations of "nonpecuniary benefits like those supposed to arise from employee ownership of employee stock" cannot preclude considerations of "*financial* benefits (such as retirement income)." *Id.* at 420-21 (emphasis in original). The Court pointed out that ERISA's duty of loyalty is defined by "the 'exclusive purpose'" of "'providing benefits to participants and their beneficiaries.'" *Id.* at 420.

B. ESOP Fiduciaries, Like Any Other Fiduciaries, Are Obligated to Use Their Knowledge and Skill to Advance the Interests of the ESOP.

Petitioners' argue that there is no "duty of insider fiduciaries to take inside information gathered in their corporate capacity and use it in their fiduciary capacity to benefit plan participants." Pet'rs Br. at 2. Petitioners then go further to assert, without citation to authority, that "as this Court has recognized, the

corporate and fiduciary duties are distinct, and when a corporate officer wears her fiduciary hat, there is no obligation to use inside information gathered in her corporate capacity." *Id.* at 20, 22.

Petitioners' arguments were expressly rejected by the Court in *Dudenhoeffer*. In *Dudenhoeffer*, the Court set out a test for determining whether an ESOP fiduciary's "failing to act on the basis of nonpublic information that was available to them because they were . . . corporate insiders," presents a cognizable claim. *Dudenhoeffer*, 573 U.S. at 427-28. The Court held that "a claim for breach of the duty of prudence on the basis of inside information" would lie if a plaintiff plausibly alleges "an alternative action that the defendant could have taken that would have been consistent with the securities laws and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the fund than to help it." *Id.* at 428.

Thus the Court did not simply recognize, in the abstract, that ESOP fiduciaries have an obligation to use information they learn in their corporate capacity to benefit the ESOP. Instead, the Court carefully set forth a test describing the minimum facts that need to be alleged to state a claim for breach of fiduciary duty for failing to act on that information. The Petitioner's primary argument, accordingly, is entirely foreclosed by *Dudenhoeffer*. Many other courts considering the question prior to *Dudenhoeffer* rejected precisely the same argument that Petitioners advance here.[16]

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16 "When a corporate insider puts on his ERISA hat, he is not assumed to have forgotten adverse information he may have acquired while acting in his corporate capacity." *In re WorldCom*,

The United States also effectively rebuts Petitioner's argument, and *amici* agree with its analysis in that regard. Govt. Br. at 28-31. The article cited by the United States, Steven R. Hunsicker, *Conflicts of Interest, Economic Distortions, and the Separation of Trust and Commercial Banking Functions*, 50 S. CAL. L. REV. 611, 631 (1977), *see* Govt. Br. at 30, accurately characterizes the common law duty of trustees not just to use information for the benefit of trust, but to actively seek out such information for the benefit of the trust. *See also* Hess, et al., BOGERT'S THE LAW OF TRUSTS AND TRUSTEES § 612 at nn.73-78 and accompanying text (2019 online ed.) ("Bogert's Trusts and Trustees") (discussing conflicts of interest between bank trust departments, which have a duty to beneficiaries to act on basis of all information regarding securities held in trust, and the bank's commercial department, which often controls a seat on the board of the company whose shares are held in trust by the trust department and which thereby obtains inside information about the company); Francis J. Bruzda & Richard B. Seidel, *Bank Trust Departments and the 10b-5 Dilemma*, 21 VILLANOVA L. REV., 367, 376-77 (1976). While, as the Court explained in *Dudenhoeffer*, there is no fiduciary duty to break the law by trading on inside information, the underlying fiduciary duties in the law of trusts and ERISA certainly contain no generalized rule that a fiduciary who serves two masters is entitled to forget information from one fiduciary role in performing the other, as Petitioners contend.

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263 F. Supp. 2d at 765; *see also, e.g., Woods v. Southern Co.*, 396 F. Supp. 2d 1351, 1373 (N.D. Ga. 2005); *In re Schering-Plough Corp. ERISA Litig.*, No. CIV.A. 03-1204 (KSH), 2007 WL 2374989, at *9 (D.N.J. Aug. 15, 2007).

Petitioners argue that permitting corporate insiders to serve as ESOP fiduciaries provides "advantages to both employers and employees," including "allowing companies to manage their ERISA plans internally, reducing costs and taking advantage of their own officers' expertise and judgment." Pet'rs Br. at 23. But what "advantage" does low-cost expert judgment offer an ESOP if the officers are excused from attending to workers' interest when the going gets tough? Under the common law of trusts, the general rule has long been that a fiduciary who "has . . . greater skill than that of a man of ordinary prudence" is obligated "to exercise such skill" for the benefit of the trust. RESTATEMENT (SECOND) OF TRUSTS, § 174; *see also* Austin W. Scott and Mark L. Ascher, SCOTT AND ASCHER ON TRUSTS § 17.6 (5th ed. 2006) (if "a particular trustee has greater skill or more facilities than those of the ordinary prudent person" then "the trustee is under a duty to use the trustee's actual skills and to employ all reasonably available facilities") (collecting cases).

More generally, the Petitioner's argument boils down to the proposition that if a conflict arises between the duties of ESOP fiduciaries and the duties of corporate officers, then ESOP fiduciaries are excused from their obligations to the ESOP. That is not reasoned accommodation of the requirements of ERISA and federal securities law, it is utter subordination of ERISA's goal of protecting workers' interest in employee benefit plans. *Dudenhoeffer* rejected precisely that argument, and for good reason. Serving as an ESOP fiduciary entails significant responsibility for participants' retirement savings. Although Congress declined to automatically prohibit officers and employees of plan

sponsors from 'wearing two hats' by also serving as plan fiduciaries, 29 U.S.C. § 1108(c)(3), nothing in the statutory scheme exempts them from the foundational obligations to act prudently and "solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefits" and defraying reasonable costs of plan administration. 29 U.S.C. § 1104(a)(1)(A).

If the corporate officer/ESOP fiduciary faces a conflict of interest between their corporate and ERISA roles, that is indeed a problem, and one that the fiduciary should spare no effort to ameliorate as rapidly as possible. This Court has several times remarked that ERISA requires fiduciaries to "avoid[] . . . conflicts of interest." *Massachusetts Mut.*, 473 U.S. at 143; *Mertens v. Hewitt Assocs.*, 508 U.S. 248, 252 (1993) (same). Here, Petitioners all but admit that they had conflicting interests, Pet'rs Br. at 23, but argue that Congress meant to relieve ERISA fiduciaries from responsibility for any conflicted conduct by adopting the prohibited transaction exemption in § 1108(c)(3). But that reads far too much into § 1108(c)(3). Absent § 1108(c)(3), a corporate officer who serves as an ERISA fiduciary would run the risk of *automatically* violating the prohibited transaction rules of § 1106—merely exempting that service from constituting an automatic violation is far from a broad license to actually engage in conflicted transactions involving the IBM Plan, as Petitioners suggest (without supporting authority). As Judge Friendly explained in *Bierwirth* in response to a similar argument about § 1108(c)(3):

> Although officers of a corporation who are trustees of its pension plan do not violate

> their duties as trustees by taking action which, after careful and impartial investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves, their decisions must be made with an eye single to the interests of the participants and beneficiaries.

Bierwirth, 680 F.2d at 271.

To the extent a fiduciary, who is also a corporate officer, feels a conflict between their roles, at a minimum they should take action to protect the plan. *Bierwirth* is again instructive. In that case, corporate officer-fiduciaries faced a conflict of interest between their roles in the face of a hostile tender offer. Because the fiduciaries "should have realized that, since their judgment on this score could scarcely be unbiased, at the least they were bound to take every feasible precaution to see that they had carefully considered the other side . . . " *Id.* at 276. When it is "possible to question the fiduciaries' loyalty, they are obliged at a minimum to engage in an intensive and scrupulous independent investigation of their options to insure that they act in the best interests of the plan beneficiaries." *Leigh v. Engle*, 727 F.2d 113, 125–26 (7th Cir. 1984). That compliance with ERISA and the securities laws is challenging is no reason those laws should not both be rigorously applied, as Petitioners suggest.[17]

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[17] Notably, Petitioners' arguments are not cabined to ESOPs holding publicly traded securities, where fiduciaries face securities-law-imposed limits on trading based on undisclosed inside information. Relieving ESOP fiduciaries of their obligation to consider information learned in their corporate capacity when acting as

C. Petitioners' Reliance on *Pegram v. Herdrich* Is Misplaced.

Petitioners also argue at length that this Court's decision in *Pegram v. Herdrich*, 530 U.S. 211 (2000) supports relieving ESOP trustees of their ERISA fiduciary duties. Petitioners' argument is contrary to *Dudenhoeffer*, which (unlike *Pegram*) dealt specifically with ESOP fiduciaries and which, as set forth above, expressly rejected a lower fiduciary standard for ESOP fiduciaries. The government's rejection of Petitioners' *Pegram* argument is well reasoned, *see* Govt. Br. at 29-31, and *amici* agree with the government's analysis to that extent.

In *Pegram*, the Court ruled that physicians working for HMOs were not subject to ERISA's fiduciary duties when they made treatment decisions: "Congress did not intend [the physician] or any other HMO to be treated as a fiduciary to the extent that it makes mixed

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an ESOP fiduciary could have dramatic and unfortunate consequences for ESOPs holding stock of closely held companies, where the securities laws have little application, and where fiduciaries and corporate insiders often engage in transactions to purchase and sell securities directly with the ESOPs. Unfortunately, given the lower profile of privately-held companies, the lack of a market benchmark for valuing securities, and the conflicts of interest between plan fiduciaries and company ownership, ESOPs of privately-held companies have given rise to frequent flagrant abuses. The Department of Labor, for example, has identified ESOP transactions as a "national enforcement project" on which its "field offices are to place particular investigative emphasis." *See* Department of Labor, Employee Benefits Security Administration, Enforcement, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement. Numerous reported cases involve private ESOP transactions, including the cases cited *supra* n.2; *see also Perez v. Bruister*, 823 F.3d 250 (5th Cir. 2016); *Hall Holding Co.*, 285 F.3d 415.

eligibility decisions acting through its physicians." *Pegram*, 530 U.S. at 231. Nothing in ERISA's fiduciary standards expressly relates to HMOs or mixed treatment-eligibility determinations. And those determinations, while not subject to ERISA, remain subject to state medical malpractice laws. *Id.* at 236-37.

ERISA contains a detailed regulatory regime specifically governing fiduciary duties in public and private ESOPs. *See* 29 U.S.C. §§ 1104(a)(2); 1106(a)(1)(E); 1106(a)(2); 1107, 1108(b)(3); 1108(b)(12); 1108(e). Moreover, while nothing in ERISA addressed the tension between the obligations of a treating physician and ERISA's fiduciary duties, ERISA does contain an exemption from its fiduciary duties specifically directed at ESOPs—relief from the diversification duty set out in 29 U.S.C. § 1104(a)(2). *See Dudenhoeffer*, 573 U.S. at 416-19. If nothing else, the ESOP diversification exemption in 29 U.S.C. § 1104(a)(2) is surely incompatible with Petitioner's assertion that ERISA's other fiduciary duties do not apply to ESOP fiduciaries. *Id.* at 419.

III. Respondents' Specific Factual Allegations Suggest Conduct Incompatible with ERISA's Fiduciary Duties.

The Petitioners' brief never truly confronts the two key, case-specific factual allegations alleged by the plaintiffs. First, the Second Circuit and district court agreed that the plaintiffs plausibly alleged that the IBM "stock was artificially inflated through accounting violations." *Jander*, 910 F.3d at 628. In particular, "[t]hrough what [plaintiff] deems accounting legerdemain, IBM failed to publicly disclose [annual losses approaching $700 million in its microelectronics

business] and continued to value the business at approximately $2 billion." *Id.* at 623 (quoting the district court's opinion).

Second, two of the IBM Plan's fiduciaries "had the power to disclose the truth to the public and correct the artificial inflation." The Second Circuit pointed out that the *ESOP's fiduciaries* were the corporate officers with "primary responsibility for the public disclosures that had artificially inflated the stock price to begin with." *Id.* at 628-29. In this case, then, the ESOP's fiduciaries had "primary responsibility" for making the very public disclosures at issue, and the disclosures they made reflected "accounting violations" that inaccurately disclosed that a business unit losing $700 million per year was worth $2 billion. *Id.* at 623 & 628-29.

It is difficult to imagine how a fiduciary could have determined that providing accurate disclosures, in place of inaccurate disclosures, would have done more harm than good to the ESOP. The Petitioner's brief argues at great length that the "could not have" standard from *Dudenhoeffer* applies, Pet'rs Br. at 33-44, but apparently overlooks the fact that the Second Circuit applied the "could not have" standard in this case:

> We need not here decide which of the two standards the parties champion is correct, however, because we find that Jander plausibly pleads a duty-of-prudence claim even under the more restrictive "could not have concluded" test.

Jander, 910 F.3d at 628.

Petitioners contend that their actions are justified because the ESOP's participants "do not have uniform interests," and some were sellers who, Petitioners suggest, might prefer an artificially inflated share price. Pet'rs Br. at 43. But no ESOP participant has a legally protectable interest in selling shares at an artificially inflated price as a result of inaccurate securities disclosures.[18] More to the point, perhaps, Petitioners do not contend that they in fact balanced the ESOP participants' interests when they decided to make the inaccurate disclosures. Petitioners are before this Court seeking to close the door on discovery, so that no one will ever find out what, if anything, Petitioners actually considered about the ESOP participants' interests when they made their inaccurate securities disclosures, or whether Petitioners engaged any other careful, reasoned, informed, conflict-free consideration of the competing interests. And, as set forth above, the issue here is not just what a prudent fiduciary could have concluded, but whether Defendants—who were allegedly acting under a conflict of interest and violating their duty of loyalty to the ESOP—in fact placed the interests of themselves or

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[18] *Henderson v. Emory Univ.*, No. 1:16-CV-2920-CAP, 2018 WL 6332343, at *8 (N.D. Ga. Sept. 13, 2018) ("If including those investments constitutes a breach, each participant has the same legal interest of having the Plans' resulting losses restored and the imprudent investments removed; none of them would have a legal interest in maintaining investments that run afoul of ERISA."); *Sacerdote v. New York Univ.*, No. 16-CV-6284 (KBF), 2018 WL 840364, at *4 (S.D.N.Y. Feb. 13, 2018) ("[N]o plan participant would have a legal interest in continuing to invest in a plan that was adjudged imprudent.").

IBM management ahead of the interests of the ESOP's participants by making inaccurate disclosures.

CONCLUSION

When Congress adopted ERISA, it did so to provide a bulwark to preserve employee retirement benefits—a bulwark meant to protect against even well-intentioned but imprudent corporate officers. ERISA's fiduciary duties were meant to impose even more stringent standards of fiduciary conduct than those found in the common law of trusts.

As this Court explained in *Dudenhoeffer*, those fiduciary duties apply to ESOP fiduciaries as well as other ERISA plan fiduciaries. That corporate officers who serve as ESOP fiduciaries may find compliance with their fiduciary duties difficult is no accident, as the consequences of fiduciary misfeasance and malfeasance are dramatic and severe for the employees who count on their plans to sustain them in retirement.

For these reasons, *amici* urge the Court to affirm the Second Circuit's well-reasoned opinion, and remand to the district court for further factual development.

Respectfully Submitted,

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