MANAGING A COMPANY STOCK FUND -- WHEN MUST AN ERISA FIDUCIARY SELL EMPLOYER STOCK?[1]

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Introduction

May the fiduciary of an employee benefit plan covered by the Employee Retirement Income Security Act of 1974 ("ERISA")[2] continue to hold and purchase stock of the plan sponsor if the plan sponsor is teetering on the edge of bankruptcy? May a fiduciary continue to hold and purchase stock of the plan sponsor if management has misstated earnings or engaged in other improper conduct? If the plan sponsor's stock simply declines in value significantly, may the fiduciary be held liable for holding on to the stock on the way down?

A fiduciary confronting these issues often is placed in the uncomfortable position of deciding between compliance with express provisions of the plan that mandate investment in the plan sponsor's stock or selling the stock in order to avoid claims of breach of fiduciary duty. Making the situation even more difficult, the fiduciary must realize that if it ignores the plan provisions and sells the plan sponsor's stock, it could be held liable by plan participants if the stock recovers.

These problems are real, not academic. ERISA "stock drop" cases are becoming common and frequently follow the almost inevitable securities class action that is filed whenever a publicly held corporation's stock declines due to a negative development and the attendant publicity. According to one published report, up to fifty ERISA stock drop cases may have been filed in a two-year period alone.[3]

Statutory Guidance

In order to qualify as an employee stock ownership program ("ESOP") under ERISA, a plan must be "designed to invest primarily in qualifying employer securities . . . ."[4] To satisfy

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[2] ERISA is codified at 29 U.S.C. § 1001 et seq. All citations in this paper (other than those appearing in a quotation) will be to the ERISA sections rather than the sections of 29 U.S.C.

[3] Steven J. Mintz, *New Species of ERISA Claims Evolves: Securities Litigation's Genetic Offspring?*, LITIG. NEWS, March 2006, at 6.

[4] ERISA, Pub. L. No. 93-406, § 407(d)(6)(A) (2006).

this requirement and garner the special treatment afforded to ESOPs by federal law, the plan documents for an ESOP will specifically require the fiduciaries to invest "primarily" or sometimes almost exclusively in the stock of the plan sponsor. Section 401(k) plans and other defined contribution plans that provide for the investment in employer securities often contain similar language. In fact, the plan documents for these programs commonly state that the so-called "company stock fund" will be invested exclusively in stock of the plan sponsor and, perhaps, a small cash reserve to meet liquidity needs. Some plans also characterize the company stock fund as an ESOP, thus triggering the special features available under ERISA and the Internal Revenue Code that apply to ESOPs alone.

Section 404(a)(1)(D) of ERISA requires the fiduciaries of an ERISA covered plan to administer the plan "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and Title IV."[5] As a result, a simple reading of section 404(a)(1)(D) might lead one to conclude that the language of the statue provides a ready solution to the fiduciary's dilemma. This literal reading of the statute suggests that the fiduciary is required to retain, and perhaps continue to invest in, the plan sponsor's stock, even in the face of financial reversals, if the plan document requires it to do so.

But what about the concluding language of section 404(a)(1)(D) that permits a fiduciary to follow the plan language only "insofar as such documents and instruments are consistent with the provisions of this title and Title IV?" Does this language negate the answer provided by the first part of the same clause? After all, ERISA also requires the fiduciaries of all covered plans to comply with the so-called prudent person standard of section 404(a)(1)(B), which mandates that a fiduciary act "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."[6] Section 404(a)(2) of ERISA does state that ERISA's general diversification requirement "and the prudence requirement (only to the extent that it requires diversification) . . . is not violated by acquisition or holding of . . . qualifying employer securities" if the plan is an "eligible individual account plan" within the meaning of section 407(d)(3) of ERISA.[7] Nevertheless, on its face, this provision does not purport to completely replace the general prudence requirement.[8]

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[5] ERISA, § 404(a)(1)(D).

[6] ERISA, § 404(a)(1)(B).

[7] ESOPs and well-drafted 401(k) and other defined contributions that include employer stock funds will qualify as "eligible individual account plans."

[8] In Armstrong v. Lasalle National Association, 446 F.3d 728, 732 (7th 2006), an ESOP valuation case, Judge Posner commented on the fiduciary duty of an ESOP trustee as follows: "The duty of an ERISA trustee to behave prudently in managing the trust's assets, which in this case consisted of the assets of the ESOP, is fundamental. This is true even though, by the very nature of an ESOP, the trustee does not have a *general* duty to diversify, though such a duty can arise in special circumstances . . . the duty to diversify is an essential element of the ordinary trustee's duty of prudence, given the risk aversion of trust beneficiaries, but the absence of any general such duty from the ESOP setting does not eliminate the trustee's duty of prudence. If anything, it demands an even more watchful eye, diversification not being in the picture to buffer the risk to the beneficiaries should the company encounter adversity. There is a sense in which, because of risk aversion, an ESOP is imprudent per se, though legally authorized. This built-in "imprudence" (for which the trustee is of course not culpable) requires him to be especially carefully to do nothing to increase the risk faced by the participants still further." (citations omitted)

For a number of years, the courts (or at least most courts) dealt with these difficult issues by following the Third Circuit's 1995 decision in Moench v. Robertson.[9] Recently, though, in Wright v. Oregon Metallurgical Corp.[10] the Ninth Circuit questioned the Moench approach. The Ninth Circuit reaffirmed its decision in Wright and again declined to adopt the Moench presumption in In re Syncor ERISA Litigation.[11] Following the Ninth Circuit's decisions, several district courts have declined to apply the presumption and at least two district court cases have expressly rejected Moench. The courts rejecting Moench have opted for the literal reading of sections 404(a)(2) and 404(a)(1)(D) mentioned above. As also will be discussed below, other district court cases have reached the same result without even referring to Moench.

The Moench Presumption

In Moench, an ESOP's administrative committee continued to invest participant and employer contributions in the securities of the plan sponsor, a bank holding company, even though the fiduciaries recognized that the holding company's financial situation was precarious at best. The plan sponsor ultimately failed and a participant filed a lawsuit against the committee. Citing common plan language that required that the assets of the plan be invested "primarily" in employer securities, the district court found that the administrative committee was obligated to invest the plan assets in the plan sponsor's securities and could not be faulted for doing so.

The plaintiff appealed on several grounds, but the principal issue confronting the Third Circuit related to whether an ESOP fiduciary ever could be faulted for investing in employer securities:

> This case requires us to decide the following difficult question: To what extent may fiduciaries of Employee Stock Ownership Plans (ESOPs) be held liable under the Employee Retirement Income Security Act (ERISA) for investing solely in employer common stock, when both Congress and the terms of the ESOP provide that the primary purpose of the plan is to invest in the employer's securities.[12]

After examining the language of the plan and the common law of trusts, the court concluded that although deference should be given to the fiduciary's decision, a fiduciary should not be allowed to blindly continue to acquire employer securities in all instances. Instead, according to the Third Circuit, an ESOP fiduciary's decision to continue to invest in employer securities when the employer is suffering financial problems should be reviewed for an abuse of discretion. The court held as follows:

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[9] 62 F.3d 553 (3d Cir. 1995); see also Ward v. Avaya Inc., 299 Fed. Appx. 196 (3d Cir. 2008) (applying Moench); Edgar v. Avaya Inc., 503 F.3d 340 (3d Cir. 2007) (same).

[10] 360 F.3d 1090 (9th Cir. 2004).

[11] 516 F.3d 1095, 1102 (9th Cir. 2008) ("As an initial matter, this Circuit has not yet adopted the Moench presumption [citing Wright] and we decline to do so now.").

[12] Id. at 556.

> In light of the analysis detailed above, keeping in mind the purpose behind ERISA and the nature of ESOPs themselves, we hold that in the first instance, an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities.[13]

The Sixth Circuit Decision in Kuper

The Sixth Circuit applied the Moench rationale to a non-bankruptcy situation in Kuper v. Iovenko.[14] In Kuper, the plaintiffs were participants in a 401(k) plan under which the employer's "matching contributions" were deposited into a company stock fund that was designated as an ESOP. Following the plan sponsor's acquisition by another organization, the plan fiduciaries continued to invest the ESOP portion of the plan in plan sponsor securities pending the plan's termination. In the approximately eighteen months between the date of the acquisition and the actual liquidation of the employer securities, the stock declined in value from $50 to $10. The plaintiff sued, alleging that the fiduciaries responsible for the ESOP portion of the plan violated their duties under ERISA. The Sixth Circuit disagreed.

Noting the competing policies reflected in Congress's desire to encourage employee ownership and the fiduciary standards of ERISA, the court decided to adopt the Third Circuit's approach:

> In Moench, the Third Circuit attempted to find "a way for the competing concerns [of ERISA fiduciaries and ESOPs] to coexist." In determining that subjecting an ESOP fiduciary's investment decisions to a strict standard of review was inappropriate, the Third Circuit noted that such scrutiny "would render meaningless the ERISA provision excepting ESOPs from the duty to diversify." This, in turn, would risk transforming ESOPs into ordinary pension

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[13] Id. at 571.

[14] 66 F.3d 1447 (6th Cir. 1995). Several district courts in the Sixth Circuit have applied the Kuper presumption of reasonableness. See e.g., Banks v. Healthways, No. 3:08-0734, 2009 WL 211137, at *2 (M.D. Tenn. 2009) (following Kuper and opining that a plaintiff may rebut the "presumption of reasonableness by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision"); In re Diebold ERISA Litig., No. 5:06 CV 0170, 2008 WL 2225712, at *8-9 (N.D.OH 2008) (same); In re Ford Motor ERISA Litig., 590 F. Supp.2d 883 (E.D. Mich. 2008) (noting that plaintiffs do not need to plead "impending" or "imminent collapse" to overcome the Kuper presumption); Shirk v. Fifth Third Bancorp., No. 05-cv-49, 2007 WL 1100429, at *10 (S.D. Ohio April 10, 2007) (finding that plaintiffs alleged sufficient facts to rebut the presumption of reasonableness because plaintiffs alleged that defendants "knew or should have known that Fifth Third was engaged in numerous practices that put Fifth Third stock at risk, that they failed to take into account whether the stock was inflated in value, that they created or maintained public misconceptions concerning the true financial health of the Company, and despite the availability of other investment options, continued to invest and allow investment of the Plan's assets in Fifth Third stock even as Fifth Third's questionable practices came to public light").

plans, thus frustrating Congress's desire to encourage employee ownership and contravening the intent of the parties.

> The Third Circuit found that the better balance between these concerns was achieved by measuring a fiduciary's decision to continue investing in employer securities for an abuse of discretion. Thus, it held that "keeping in mind the purpose behind ERISA and the nature of ESOPs themselves, . . . an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion . . . ."[15]

Other Courts

The First Circuit lined up with the Third and Sixth Circuits in LaLonde v. Textron, Inc.[16] In LaLonde, 50% of employee contributions and 100% of employer matching contributions were invested in an employer stock fund that held only Textron common stock. Plaintiffs claimed that the defendants violated their fiduciary obligations under ERISA by continuing to invest in Textron stock, since they knew or had reason to know that Textron stock would decline in value. According to the plaintiffs, and as reported in the decision, Textron's earnings declined 70% during the class period and Textron concealed internal problems that led to a decline in earnings and value.

The defendants filed a motion to dismiss, which was granted by the district court. Although the First Circuit seemingly approved the basic approach taken in Moench and Kuper, it disagreed with the district court's "distillation of the breach of fiduciary standard into the more specific decisional principal extracted from Moench, Kuper and Wright . . . ."[17] In essence, the court disagreed with the district court's views regarding the showing needed to overcome the Moench presumption, a topic discussed below.

The Fifth and Seventh Circuits also have cited Moench with apparent approval[18] and numerous district court cases have followed the Moench approach.[19]

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[15] Id. at 1458–59 (citations omitted).

[16] 369 F.3d 1 (1st Cir. 2004). In Bunch v. Grace & Co., the First Circuit declined to apply the presumption to a fiduciary's decision to *divest the plan of employer stock* when the fiduciary "engaged in a substantively sound, reasonable analysis of all relevant circumstances appropriate to the decision to sell the [employer's] stock." Bunch v. W.R. Grace & Co., 555 F.3d 1, 10 (1st Cir. 2009) (opining that although the presumption "serves as a shield for a prudent fiduciary" in a stock drop case, the "standard transforms into a sword to be used against the prudent fiduciary" in a case such as this, when, "based on the facts *then known*, [the fiduciary] made an assessment after appropriate and thorough investigation of [the employer's] condition").

[17] Id. at 6.

[18] Kirschbaum v. Reliant Energy Inc., 526 F.3d 243 (5th Cir. 2008); Summers v. State Street Bank and Trust Co., 453 F.3d 404, 410 (7th Cir. 2006); Steinman v. Hicks, 352 F.3d 1101 (7th Cir. 2003).

[19] In addition to the numerous district court cases cited throughout this paper, see In re Bank of America Corp., No. 09 MD 2058 (S.D.N.Y. Aug. 27, 2010); Fisher v. JP Morgan, No. 03 Civ. 3252, 2010 WL 1257345 (S.D.N.Y. 2010); In re Citigroup ERISA Litig., No. 07 Civ. 9790, 2009 WL 27262708 (S.D.N.Y. 2009); In re Radioshack Corp. ERISA Litig., 547 F. Supp. 2d 606 (N.D. Tex. 2008); Halaris v. Viacom Inc., No. 3:06-CV-1646-N, 2008 WL

The Importance of Plan Language

A recent decision by the Third Circuit illustrates the importance of including appropriate language in the plan document in order to trigger the Moench presumption. In In re Schering-Plough Corp. ERISA Litigation,[20] the court dealt with a plan that included an employer stock fund as one of the available investment alternatives. The principal question addressed by the court related to whether the plaintiffs could seek money damages on behalf of the plan even though the fiduciary violations alleged only impacted some of the plan participants. In the process, the court also addressed the applicability of the Moench presumption when the plan document does not absolutely require the maintenance of an employer stock fund and no participant was required to invest any portion of his or her account, including any employer contributions, in Schering-Plough stock. In a footnote rejecting the application of Moench, the Third Circuit stated the following: "We find our Moench decision inapposite because the fiduciaries here were 'simply permitted to make . . . investments' in 'employer securities.' In so concluding, we express no opinion on the significance, if any, of 29 U.S.C. § 1104(a)(2) in the context of this case."[21]

Similarly, in In re WorldCom, Inc. ERISA Litigation,[22] the court found that "WorldCom stock could have been removed as one of the investments offered under the Plan without amending the Plan and plaintiffs have adequately alleged that these fiduciaries should have, but failed, to consider or recommend doing so."[23] As a result, the defendants seemingly were not entitled to the benefit of the Moench presumption. The courts in Lively v. Dynegy, Inc.[24] and Lingis v. Motorola[25] reached a similar result.

On the other hand, a carefully crafted plan document might provide a fiduciary with more protection than is offered by the Moench presumption. In Moench, the Third Circuit noted that "trust law distinguishes between two types of directions: the trustee either may be mandated or permitted to make a particular investment."[26] The court went on to note that "[i]f the trust requires the fiduciary to invest in a particular stock, the trustee must comply unless 'compliance would be impossible . . . or illegal' or a deviation is otherwise approved by the court."[27] The Moench court then fashioned its presumption to deal with the situation in which "the fiduciary is

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3855044 (N.D. Tex. 2008); Baush & Lomb Inc., No. 06-CV-6297, 2008 WL 5234281 (W.D.N.Y. 2008); Graden v. Conexant, 547 F. Supp. 2d 456 (D.N.J. 2008); Halaris v. Viacom, No. 3:06-CV-1646, 2007 WL 4145405 (N.D. Tex. 2007); In re Sears, Roebuck & Co. ERISA Litig., No. 02 C 8324, 2004 WL 407007 (N.D. Ill. 2004); Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003); and In re Duke Energy ERISA Litig., 281 F.Supp. 2d 786 (W.D.N.C. 2003). These cases represent only some of the numerous district court cases that have applied the Moench presumption.

[20] 420 F.3d 231 (3d Cir 2005).

[21] Id. at 238 n.5 (citation omitted).

[22] 263 F. Supp. 2d 745 (S.D.N.Y. 2003).

[23] Id. at 765.

[24] 420 F. Supp. 2d 949, 954 (S.D. Ill. 2006).

[25] 649 F. Supp. 2d 861, 879-880 (N.D. Ill. 2009).

[26] Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).

[27] Id. (quoting RESTATEMENT (THIRD) OF TRUSTS: PRUDENT INVESTOR RULE § 228 cmt. e (1992)).

not absolutely required to invest in employer securities but is more than simply permitted to make such investments . . . ."[28]

Using this distinction, a few district courts have at least suggested that if a plan mandates investments in employer securities, rather than simply requiring the fiduciaries to invest the assets of the plan "primarily" in employer stock, there may be no obligation to sell the employer securities even if the failure to do so might be viewed as an abuse of discretion (presumably because the fiduciaries did not have any discretion to abuse).[29]

Applicability of the Presumption to Eligible Individual Account Plans

Some courts apply the presumption as long as the plan is an eligible individual account plan and the plan document requires the fiduciaries to invest to some extent (e.g., "primarily") in employer securities.[30] Other courts have held that the Moench presumption is only available to the fiduciaries of ESOPs, apparently on the theory that the purpose of the presumption is to ease the burden on fiduciaries that is created by the conflict between the ERISA provisions favoring ESOPs and the fiduciary responsibility rules.[31] Due to the position taken in this latter line of cases, many plan documents now specifically state that the company stock fund portion of the plan is intended to be an ESOP.

Rebutting the Presumption

The Moench Court's Formula

As noted above, in Moench the Third Circuit held that the presumption in favor of the retention of employer securities could be rebutted by a showing that the fiduciary had abused its discretion. The Moench court then explained the instances in which a plaintiff could establish an abuse of discretion as follows:

> In attempting to rebut the presumption, the plaintiff may introduce evidence that "owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust." Restatement (Second) § 227 comment [q]. As in all trust cases, in reviewing the fiduciary's actions, the court must be governed by the intent behind the trust—in other words, the plaintiff must show that the ERISA fiduciary could not have

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[28] Id.

[29] In re Citigroup ERISA Litig., No. 07 Civ. 9790, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009); Smith v. Delta Air Lines, Inc., 422 F. Supp. 2d 1310 (N.D. Ga. 2006); In re McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812 (N.D. Cal. 2005); Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 WL 763873 (W.D.N.Y. Jan. 14, 2004); Nelson v. IPALCO Enters., Inc., IP02-0477-C-H/K, 2003 WL 402253 (S.D. Ind. Feb. 13, 2003).

[30] Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1097 n.3 (2004); In re Polaroid ERISA Litig., 362 F. Supp. 2d 461, 474 (S.D.N.Y. 2005); Pa. Fed'n v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan of the Norfolk S. Corp., No. Civ.A. 02-9049, 2004 WL 228685, at *7 (E.D. Pa. Feb. 4, 2004).

[31] See Urban v. Comcast, No. 08-773, 2008 WL 4739519, at *12 (E.D. Pa. Oct. 28, 2008); In re Westar Energy, Inc. ERISA Litig., No. 03-4032-JAR, 2005 WL 2403832, at *18–19 (D. Kan. Sept. 29, 2005); Unaka Co., Inc. v. Newman, No. 2:99-CV-267, 2005 WL 1118065, at *21 (E.D. Tenn. Apr. 26, 2005).

> believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate. In determining whether the plaintiff has overcome the presumption, the courts must recognize that if the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer's securities, it may face liability for that caution, particularly if the employer's securities thrive.[32]

The Third Circuit also cautioned that conflicts of interest become more likely as an employer's fortunes decline and suggested that the existence of a conflict could make an abuse of discretion more likely:

> In considering whether the presumption that an ESOP fiduciary who has invested in employer securities has acted consistently with ERISA has been rebutted, courts should be cognizant that as the financial state of the company deteriorates, ESOP fiduciaries who double as directors of the corporation often begin to serve two masters. And the more uncertain the loyalties of the fiduciary, the less discretion it has to act. Indeed, "[w]hen a fiduciary has dual loyalties, the prudent person standard requires that he make a careful and impartial investigation of all investment decisions." . . . And, if the fiduciary cannot show that he or she impartially investigated the options, courts should be willing to find an abuse of discretion.[33]

Moench provides a helpful explanation of the general principles involved in overcoming the presumption. A fair reading of Moench also certainly suggests that the Third Circuit thought that it would be the rare or limited instance in which a plaintiff could overcome this presumption. At the same time, Moench stops short of providing a concrete explanation of the circumstances that will or will not "show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate." The courts, in later cases, have attempted to provide this added guidance, and several different formulations have emerged.

The Sixth Circuit's Emasculation of the Presumption

The Sixth Circuit, in Kuper, was the first to try its hand at elaborating on the guidance provided by Moench:

> We agree with and adopt the Third Circuit's holding that a proper balance between the purpose of ERISA and the nature of ESOPs requires that we review an ESOP fiduciary's decision to invest in employer securities for an abuse of discretion. In this regard, we will presume that a fiduciary's decision to remain

[32] Moench, 62 F.3d at 571–72.
[33] Id. at 572 (quoting Martin v. Feilen, 965 F.2d 660, 670 (8th Cir. 1992)) (internal quotation marks omitted).

> invested in employer securities was reasonable. A plaintiff may then rebut this presumption of reasonableness by showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision.[34]

The Kuper approach, as expressed in the last sentence of the quoted passage from the opinion, seems inconsistent with the general idea behind the Moench presumption, namely that the fiduciary is entitled to considerable discretion and deference in deciding to retain employer securities. The Sixth Circuit's position also provides little guidance and perhaps no relief to the plan fiduciary struggling to comply with the terms of the plan and its obligations under ERISA. As the district court in Unaka Co., Inc. v. Newman[35] seemed to acknowledge, a presumption that may be rebutted by a "showing that a prudent fiduciary acting under similar circumstances would have made a different investment decision" is of little value. In fact, the court characterized a disagreement between the parties regarding the availability of the presumption as "largely an academic debate."[36]

The First Circuit Rejects a Concrete Standard

The First Circuit discussed the rebuttal of the Moench presumption in LaLonde.[37] Rather than providing concrete guidance regarding when and whether the presumption could be overcome, though, the LaLonde court rejected the district's court's attempt to do so. In its opinion, the district court relied heavily on Moench and Kuper and looked to the district court decision in Wright. The district court then found that the Moench presumption "may be overcome when a precipitous decline in the employer's stock is combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement."[38] The district court then concluded that "[t]his is not one of those cases."[39] The First Circuit disagreed with this approach:

> [W]e share the parties' concerns about the court's distillation of the breach of fiduciary standard into the more specific decisional principle extracted from Moench, Kuper, and Wright and applied to plaintiffs' pleading. Because the important and complex area of law implicated by plaintiffs' claims is neither mature nor uniform, we believe that we would run a very high risk of error were we to lay down a hard-and-fast rule (or to endorse the district court's rule) based only on the statute's text and history, the sparse pleadings, and the few and discordant judicial decisions discussing the issue we face. Under the circumstances, further record development—and particularly input from those with expertise in the arcane area of the law where ERISA's ESOP provisions intersect with its fiduciary duty requirements—seems to us

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[34] Kuper v. Iovenko, 66 F.3d 1447, 1459 (6th Cir. 1995).
[35] No. 2:99-CV-267, 2005 WL 1118065, at *21 (E.D. Tenn. Apr. 26, 2005).
[36] Id.
[37] LaLonde v. Textron, Inc., 369 F.3d 1 (1st Cir. 2004).
[38] Id. at 4 (internal quotation marks omitted).
[39] Id. at 4–5 (internal quotation marks omitted).

> essential to a reasoned elaboration of that which constitutes a breach of fiduciary duty in this context.[40]

The Ninth Circuit's Decisions in Wright and Syncor

While the First Circuit rejected the district court's opinion, the Ninth Circuit cited the district court's opinion with apparent approval in Wright.[41] Although the Wright court did not adopt the Moench presumption, the Wright court did opine as to how a plaintiff may overcome the presumption. The Ninth Circuit, like the First Circuit in LaLonde, refrained from expressly articulating a hard and fast rule regarding the allegations and proof necessary to overcome the Moench presumption; however, it did hold that "[m]ere stock fluctuations, even those that trend downward significantly, are insufficient to establish the requisite imprudence to rebut the Moench presumption."[42]

The Wright decision also suggests what might be required generally. In Wright, the Ninth Circuit found that the plaintiffs had not overcome the presumption by distinguishing several cases in which the presumption had been overcome. The Ninth Circuit began its analysis by comparing the facts in Wright with those in Moench:

> Unlike Moench, this case does not present a situation where a company's financial situation is seriously deteriorating and there is a genuine risk of insider self-dealing. See Moench, 62 F.3d at 572 ("[C]ourts should be cognizant that as the financial state of the company deteriorates, ESOP fiduciaries who double as directors of the corporation often begin to serve two masters."); see also LaLonde v. Textron, Inc., 270 F. Supp. 2d 272, 280 (D.R.I. 2003) (applying Moench, and reasoning that an "ESOP fiduciary's presumption of reasonableness may be overcome when a precipitous decline in the employer's stock *is combined* with evidence that the company is on the brink of collapse or undergoing serious mismanagement.").
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> Though Plaintiffs contend that the district court prematurely dismissed their claims at the motion to dismiss stage, Plaintiffs' alleged facts effectively preclude a claim under Moench, eliminating the need for further discovery. The published accounts of Oremet's earnings and financial fundamentals during the relevant period, attached to the complaint, demonstrate that Oremet was far from the sort of deteriorating financial circumstances involved in Moench and was, in fact, profitable and paying substantial dividends throughout that period.[43]

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[40] Id. at 6 (citation omitted).
[41] Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1098–99 (9th Cir. 2004).
[42] Id. at 1099.
[43] Id. at 1098–99 (alteration in original) (citation omitted).

In a footnote, the Ninth Circuit also distinguished the facts in Wright from the facts in two district court cases that had followed Moench:

> Plaintiffs point to two decisions that are allegedly counter to this analysis, Stein v. Smith, 270 F. Supp. 2d 157 (D. Mass. 2003), and Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003). Although in both cases the courts, applying Moench, denied 12(b)(6) motions to dismiss, each case is readily distinguishable. In Smith, the complaint specifically alleged that the company's "financial collapse," including "an accumulation of large, undisclosed losses on major projects as well as an impending liquidity crisis that was not adequately disclosed to the public," played a pivotal role in the administrators' breach of their fiduciary duties. 270 F. Supp. 2d at 164. Moreover, the complaint specifically alleged that "defendant Smith was integrally involved in making decisions about bidding and disclosure of S & W's finances, and that the other defendants either were aware or should have been aware of the mounting problems." Id. Unlike the present case, and unlike Kuper and [LaLonde], in which the only allegations involved downward fluctuations in stock price, the allegations in Smith clearly implicated the company's viability as an ongoing concern. Similarly, in Rankin, the company at issue (Kmart), went bankrupt. The complaint specifically alleged that the plan administrators "fail[ed] to give Plan participants accurate, complete, non-misleading and adequate information about the compositions of the Plans' portfolios and accurate information about Kmart and its true financial condition." Rankin, 278 F. Supp. 2d at 863.[44]

Even after several readings, the Wright standard for overcoming the presumption is unclear. Must the plaintiff show a deteriorating financial condition that threatens the company's viability coupled with the possibility of insider self-dealing, as suggested by the Ninth Circuit's references to Moench? Alternatively, is it enough if the plaintiff shows "a precipitous decline in the employer's stock . . . *combined* with evidence that the company is on the brink of collapse *or* undergoing serious mismanagement,"[45] as might appear from the reference to the district court's opinion in LaLonde?

In In re Syncor ERISA Litigation, the Ninth Circuit again declined to adopt the Moench presumption.[46] In Syncor, ESOP participants filed a class action alleging that the plan administrator and two members of the board of directors breached their fiduciary duties by investing in employer stock while it was engaged in an international bribery scheme. The district court applied the Moench presumption of prudence and found that the plaintiffs failed to rebut the presumption because the plaintiffs failed to present any evidence that Syncor knew that its financial condition was seriously deteriorating and that there was a genuine risk of insider self-

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[44] Id. at 1099 n.5 (second alteration in original).
[45] Id. at 1098 (second emphasis added).
[46] In re Syncor ERISA Litig., 516 F.3d 1095 (9th Cir. 2008).

dealing. The Ninth Circuit rejected the district court's application of the Moench presumption, stating that "this Circuit has not yet adopted the Moench presumption . . . and we decline to do so now." Although the Ninth Circuit briefly opined as to what may be required to rebut the Moench presumption, the opinion fails to clarify the ambiguity in Wright:

> The district court's determination that the [plaintiffs] did not rebut the Moench presumption based solely upon Syncor's financial viability (as shown by evidence that Syncor stock outperformed both the NASDAQ and S&P 500) is not an appropriate application of the prudent man standard set forth in either Moench or 29 U.S.C. § 1104. . . . A prudent man standard based only upon a company's alleged financial viability does not take into account the myriad of circumstances that could violate the standard. A violation may occur where a company's stock did not trend downward over time, but was artificially inflated during that time by an illegal scheme about which the fiduciaries knew or should have known, and then suddenly declined when the scheme was exposed. While financial viability is a factor to be considered, it is not determinative of whether the fiduciaries failed to act with care, skill, prudence, or diligence.[47]

District Courts Attempt to Articulate a Standard

The district court in In re McKesson HBOC, Inc. ERISA Litigation[48] attempted to clarify this ambiguity:[49]

> The parties vigorously dispute whether Moench or Wright require plaintiffs to allege that a company faced "impending doom" or "dire circumstances" to state a claim against fiduciaries for imprudently failing to diversify an ESOP. Both sides raise meritorious arguments. Plaintiffs correctly argue that neither Moench nor Wright expressly declares that such allegations are necessary. Moench holds that plaintiffs may rebut the presumption by "show[ing] that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate." Moench, 62 F.3d at 571. Common sense suggests that plaintiffs can prove that fiduciaries behaved "unreasonably" in various ways. At times, Wright seems to agree that this broad-based "reasonableness" standard controls. See Wright, 360 F.3d at 1099 ("Moench . . . merely requires fiduciaries to act reasonably"). However, Wright also appears to mandate that plaintiffs allege "unreasonableness" in a specific way: by claiming that fiduciaries

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[47] Id. at 1102.

[48] 391 F. Supp. 2d 812 (N.D. Cal. 2005).

[49] The McKesson HBOC court rejected Moench but it also analyzed the presumption as part of its alternative basis for its decision. Id. at 829–41.

> did not diversify the ESOP even though the company faced insolvency. For example, Wright found dispositive that plaintiffs could not show that a reasonable fiduciary would have had concerns about Oremet's "'viability as a company.'" Wright, 360 F.3d at 1098–99 (quoting LaLonde v. Textron, Inc., 270 F. Supp. 2d 272, 280 (D.R.I. 2003)). In addition, Wright distinguished Stein v. Smith, 270 F. Supp. 2d 157 (D. Mass. 2003) and Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003)—two cases that denied motions to dismiss under Moench—on the grounds that "the allegations in Smith clearly implicated the company's viability as an ongoing concern" and "in Rankin, the company at issue . . . went bankrupt." Wright, 360 F.3d at 1099 n.5. Finally, Wright reasoned that "[m]ere stock fluctuations, *even those that trend downward significantly*, are insufficient to establish the requisite imprudence to rebut the Moench presumption." Id. at 1099. Thus, it is difficult to reconcile Wright and Moench.[50]

Although the court concluded that it was difficult to reconcile Wright and Moench, it observed that the fiduciaries in Moench were dealing with a case in which they were required to invest "primarily" in company stock, whereas in Wright, the fiduciaries would have been forced to violate the provisions of the plan in order to sell the company stock. The court then noted as follows:

> Moench thus fashioned a rule to deal with a particular type of case: one where (1) the ESOP merely expressed a preference for investing in company stock and (2) the fiduciary did not need to violate the plan's terms to comply with plaintiffs' demands:
>
>> *In a case such as this, in which the fiduciary is not absolutely required to invest in employer securities but is more than simply permitted to make such investments,* while the fiduciary presumptively is required to invest in employer securities, there may come a time when such investments no longer serve the purpose of the trust, or the settlor's intent. . . . [W]e hold that in the first instance, an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities. In attempting to rebut the presumption, the plaintiff may introduce evidence that "owing to circumstances not known to the settlor and not anticipated by him [the making of such investment] would defeat or

[50] Id. at 829–30 (alterations in original) (footnotes omitted).

> substantially impair the accomplishment of the purposes of the trust."

Id. (quoting Rest. (Second) Trusts § 227 com. q).[51]

According to the McKesson HBOC court, the fiduciaries in Wright faced a much more difficult situation:

> Critically, unlike Moench, where the fiduciaries could have complied with both the plan and plaintiffs' demands, in Wright, "[s]elling the stock . . . would have been in violation of the Plan's express terms." Id. Thus, unlike Moench, Wright did not deal with claims that fiduciaries erred by taking some action that they were "more than simply permitted" but "not absolutely required" to do. Moench, 62 F.3d at 571. As Moench acknowledged, a different rule should apply when a plaintiff claims that an ESOP fiduciary imprudently failed to *violate the plan*. See id. ("[i]f the trust requires the fiduciary to invest in a particular stock, the trustee must comply unless 'compliance would be impossible . . . or illegal' or a deviation is otherwise approved by the court") (quoting Rest. (Third) Trusts § 228, com. e). The provision in the Restatement (Second) of Trusts upon which Moench relies provides that when a trust does not permit the sale of a particular asset, the trustee may face liability for failing to apply for permission to deviate from the trust only "if there is an emergency." Rest. (Second) Trusts § 167(2). The Restatement explains that an "emergency" occurs when a trust holds stock that is likely to become "worthless":
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>> A bequeaths certain shares of stock to B in trust. By the terms of the trust B is not authorized to sell the shares. *Owing to a change of circumstances the shares become highly speculative and it is probable as the trustee realizes that they will ultimately become worthless,* and a reasonable trustee would apply to the court for permission to sell the shares. B retains the shares and makes no application to the court. The shares become worthless. B is liable to the beneficiary.
>
> Id. coms. g–h, ill. 24. Although Wright did not expressly adopt this standard, it faithfully applies it. Wright held that plaintiffs must allege "the sort of deteriorating financial circumstances involved in Moench" to state a claim. See Wright, 360 F.3d at 1098. Moench involved a company whose common stock fell from $18.25 to 25 cents in two years, making "the employees'

[51] Id. at 830–31 (alterations in original) (footnotes omitted).

> ESOP accounts virtually worthless." See Moench, 62 F.3d at 557–59. Thus, Wright suggests that a plaintiff can only state a claim for a fiduciary's imprudent failure to violate the plan and diversify an ESOP by alleging that the company faced insolvency.[52]

The court then expressly disagreed with an earlier district court case, In re Syncor ERISA Litigation,[53] that held the Moench presumption could be overcome by alleging either that "(1) a company faced impending bankruptcy or (2) was being seriously mismanaged."[54]

Like the court in McKesson HBOC, the district court in Smith v. Delta Air Lines, Inc.[55] rejected Moench. Similar to McKesson HBOC, the court also felt compelled to provide an alternative basis for its holding and, in doing so, commented on what is required to overcome the Moench presumption:

> Assuming, arguendo, that the Court of Appeals decides to adopt Moench, Count I still should be dismissed for another reason. Defendants do not deny that, as in Moench, Delta's stock suffered a serious decline in value during the Class Period. Defendants insist, however, that such a decline, without more, is insufficient to survive a motion to dismiss. Defendants claim that in addition to a precipitous stock decline, Moench requires that the fiduciaries have knowledge of impending collapse or, as other courts have held, have knowledge of some other impropriety, such as misrepresentation, fraud, or accounting irregularities.
>
> The Court agrees. A mere decline in stock value, absent knowledge of impending collapse or some other impropriety, is insufficient under Moench and cases interpreting it. Plaintiff cited cases for the proposition that impending collapse was not a prerequisite. However, all of these cases involved one of the other improprieties. See, e.g., In re Sprint Corp. ERISA Litig., 388 F. Supp. 2d 1207, 1223–24 (D. Kan. 2004) (involving misrepresentation and a companion securities fraud class action resulting in $50 million settlement); Hill v. BellSouth Corp., 313 F. Supp. 2d 1361, 1368 (N.D. Ga. 2004) (involving accounting irregularities and corporate misstatement of earnings); In re Sears, Roebuck & Co. ERISA Litig., 2004 U.S. Dist. LEXIS 3241, *7–9 (N.D. Ill. 2004) (misrepresentation in SEC filings that Sears' credit card uncollectible accounts method adequately allowed for losses). Thus, in order to allege abuse of discretion, Plaintiff must allege

[52] Id. at 831 (alterations in original) (footnotes omitted).
[53] 351 F. Supp. 2d 970 (C.D. Cal. 2004).
[54] McKesson HBOC, 391 F. Supp. 2d at 843 (citing Syncor, 351 F. Supp. 2d at 981–82).
[55] 422 F.Supp. 2d 1310, 1331 (N.D. Ga. 2006).

> either (1) knowledge of impending collapse or (2) some other impropriety.[56]

The district court in In re Duke Energy ERISA Litigation[57] suggested that in order to overcome the presumption the plaintiffs must plead and prove that the plan sponsor is near "impending collapse" or in "dire circumstances."[58] The court in In re Polaroid ERISA Litigation,[59] adopted a slightly different formulation. It concluded that the plaintiffs must show "(1) that there was a 'precipitous decline' in the price of the stock and (2) that the fiduciary had 'knowledge of its impending collapse.'"[60]

In Morrison v. MoneyGram International, Inc., the district court acknowledged that a plaintiff could overcome the presumption by pleading and proving that the employer was on the verge of collapse, but noted that this is not the *only* way that a plaintiff may overcome the presumption.[61] The court then adopted an "excessive-risk" standard:

> [T]his Court finds that the [Moench] presumption of prudence means that 29 U.S.C. § 1104(a)(1)-(2) requires fiduciaries to divest their plans of company stock when holding it becomes so risky-that is, so imprudent-that the problem could not be fixed by diversifying into other assets. In other works, with respect to EIAPs, an abuse of discretion under [Moench] begins (and the presumption of prudence ends) at the point at which company stock becomes so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would invest *any* plan assets in it, regardless of what other stocks were also in that plan's portfolio. . . .[T]his excessive-risk standard comports with the statutory exemption from the diversification requirement. The Moench presumption may not be overcome by proof that the EIAP fiduciary invested *too heavily* in employer stock, but only by proof that the fiduciary should not have invested *at all* in employer stock. . . .[T]he excessive-risk standard does not provide a bright-line rule for fiduciaries, but given that the statutory prudence standard itself provides no bright-line rules, it would be inconsistent with ERISA to create one. Alleging that the employer was on the verge of collapse is certainly one way to show that the employer's stock was excessively risky, but it would

56 Id. at *56–57.

57 281 F. Supp. 2d 786, 794–95 (W.D.N.C. 2003). See also In re Coca-Cola Enterprises Inc., ERISA Litig., No. 1:06-CV-0953, 2007 WL 1810211, at * 10 (N.D. Ga. 2007) (opining that the "Moench standard runs counter to the plain language of ERISA", and clarifying that even if the Moench standard were applied, "it would still be appropriate only where a company is on the verge of financial collapse); Mellot v. Choicepoint, Inc., 561 F. Supp. 2d 1305 (N.D. Ga. 2007) (vacated pursuant to settlement) (refusing to apply Moench but noting that the Moench approach is "more tenable" if the company is "truly on the brink of collapse").

58 Id. at 795.

59 362 F. Supp. 2d. 461, 475–76 (S.D.N.Y. 2005).

60 Id. at 475.

61 Morrison v. MoneyGran International, Inc., 607 F. Supp. 2d 1033, 1053 (D. Minn. 2009).

> be inconsistent with ERISA to hold, as a matter of law, that such an allegation is the only way to state a claim.[62]

Summary

So, what is the prevailing standard for overcoming the Moench presumption? What must a plaintiff plead and prove in order to "show that the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate?"[63] The simple answer is that it depends on the court.

The Sixth Circuit seems to require a showing that another prudent fiduciary would have sold the stock. The other cases cited above would require much more. According to the Delta court, the plaintiff must allege either "(1) knowledge of impending collapse or (2) some other impropriety."[64] An allegation of "other improprieties" would not be sufficient for the court in In re Calpine Corp. ERISA Litigation,[65] which held that the plaintiff must show that the fiduciaries knew that the "company's financial condition [was] seriously deteriorating and that there [was] a genuine risk of insider self-dealing." On the other hand, the court in In re Sprint Corp. ERISA Litigation[66] expressly rejected the "impending collapse" theory and instead looked to LaLonde for an example of the type of allegations adequate to overcome the presumption.

According to the McKesson HBOC court, it might depend on whether the fiduciaries will be required to violate the express terms of the plan if they choose to sell the stock. If they do, the court seems to suggest that the plaintiff must allege impending bankruptcy, which is the same as or very similar to the "impending collapse" or "dire circumstances" test adopted by the Duke Energy court.

The courts also disagree on whether the Moench presumption should even be considered at the motion to dismiss stage of litigation. Several courts have specifically held that the presumption should not apply at the motion to dismiss stage.[67] On the other hand, a number of other courts, including but not limited to Wright, McKesson HBOC, Calpine, and Delta, have considered the presumption at this stage.

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[62] Id. (quoting and citing In re Ford Motor Co. ERISA Litigation, 590 F. Supp. 2d 883 (E.D. Mich. 2008)).

[63] Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).

[64] Smith v. Delta Air Lines, Inc., No. 1:04-CV-2592, 2006 U.S. Dist. LEXIS 19798, at *57 (N.D. Ga. Mar. 31, 2006).

[65] No. C-03-1685, 2005 WL 1431506, at *5 (N.D. Cal. Mar. 31, 2005).

[66] 388 F. Supp. 2d 1207, 1224–25 (D. Kan. 2004).

[67] Halaris v. Viacom, Inc., No. 3:06-CV-1646-N, 2007 WL 4145405, at *10 (N.D. Tex. Sept. 21, 2007); Pietrangelo v. NUI Corp., No. Civ. 04-3223, 2005 WL 1703200, at *8 (D.N.J. July 20, 2005); In re ADC Telecomms., Inc. ERISA Litig., No. 03-2989, 2004 WL 1683144, at *6 (D. Minn. July 26, 2004); Pa. Fed'n v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan of the Norfolk S. Corp., No. Civ.A. 02-9049, 2004 WL 228685, at *7 (E.D. Pa. Feb 4., 2004); In re AEP ERISA Litig., 327 F. Supp. 2d 812, 829 (S.D. Ohio 2004); In re Elec. Data Sys. Corp. ERISA Litig., 305 F. Supp. 2d 658, 670 (E.D. Tex. 2004); see also Banks v. Healthways, Inc., No. 3:08-0734, 2009 WL 211137, at * 2 (M.D. Tenn. Jan. 28, 2009) (refusing to apply Kuper at the pleading stage); In re Diebold ERISA Litig., No. 5:06 CV 0170, 2008 WL 2225712, at *9 (N.D. Ohio May 28, 2008) (same).

The Impact of Wright and Syncor on the Moench Presumption

The courts seemed to follow Moench almost uniformly until the Ninth Circuit decision in Wright. Although it is too early to tell, following Wright a slightly different approach favoring a very literal reading of the statute may be developing.

In Wright, Oregon Metallurgical Corporation (which is referred to in the opinion as "Oremet") merged with Allegheny Teledyne. Although the Oremet plan permitted participants to diversify 85% of their employer stock investments (and thus cash out their Oremet stock, to a significant extent at least, at the value implicit in the transaction), plaintiffs sought the ability to liquidate the entire account. When Oremet refused, the plaintiffs brought a claim alleging that the fiduciaries violated ERISA's prudent person rule when they failed to sell all of the plan's stock in connection with the merger. They also claimed that the defendants violated the prudence rule when they failed to sell the stock as the value continued to decline following the merger.

As noted by the court, "[s]elling the stock in either scenario would have been in violation of the Plan's express terms."[68] The Ninth Circuit also noted that the plan was an eligible individual account plan or "EIAP" and that EIAPs were exempt from ERISA's diversification requirement as well as the prudence requirement (to the extent that it requires diversification).[69] The court then discussed Kuper and Moench in the following passage from its opinion:

> [T]he Third Circuit in Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995), followed by the Sixth Circuit in Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995), has adopted a prudence standard pursuant to § 1104(a)(1)(B) that requires EIAPs to diversify their employer stock holdings in certain circumstances. Under this standard, an EIAP fiduciary who invests in employer stock is presumed to have acted consistently with ERISA; however, a plaintiff may overcome this presumption by showing that the fiduciary abused his or her discretion. Moench, 62 F.3d at 571. To rebut that presumption, "the plaintiff must show that the ERISA fiduciary could not have believed reasonably that continued adherence to the [plan's terms] was in keeping with the settlor's expectations of how a prudent trustee would operate."[70]

The Ninth Circuit then offered the following criticism of the Moench standard:

> The Third Circuit's intermediate prudence standard is difficult to reconcile with ERISA's statutory text, which exempts EIAPs from the prudence requirement to the extent that it requires diversification. See In re McKesson HBOC, Inc. ERISA Litig.,

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[68] Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1097 (9th Cir. 2004).

[69] The court noted that the same standard applies to ESOPs and other EIAPs: "Though we decline at this juncture to adopt wholesale the Moench standard, we do note that stock bonus plans, as present in this case, and ESOPs are both EIAPs and are treated the same for the purpose of fiduciary duty analysis." Id. at 1098 n.3.

[70] Id. at 1097 (second alteration in original).

> No. C00-20030RMW, 2002 WL 31431588, at *5 (N.D. Cal. Sep. 30, 2002) (unpublished disposition) ("If there is no duty to diversify ESOP plan assets under the statute, it logically follows that there can be no claim for breach of fiduciary duty arising out of a failure to diversify, or in other words, arising out of allowing the plan to become heavily weighted in company stock"). Interpreting ERISA's prudence requirement to subject EIAPs to an albeit tempered duty to diversify arguably threatens to eviscerate congressional intent and the guiding rationale behind EIAPs themselves. See Fink[v. Nat'l Sav. & Trust Co.], 772 F.2d [951,] 956 [(D.C. Cir. 1985)] (noting that EIAPs are exempt from certain ERISA provisions because of the "strong policy and preference in favor of investment in employer stock."[71]

The Ninth Circuit specifically declined to "adopt wholesale the Moench standard,"[72] but it found that it also was unnecessary to expressly reject it:

> That said, the facts of this case do not necessitate that we decide whether the duty to diversify survives the statutory text of § 1104(a)(2). Plaintiffs' prudence claim is unavailing under any existing approach. If EIAPs are unconditionally exempt from ERISA's duty to diversify, Defendants' refusal to diversify the Plan beyond the level of 85% clearly does not constitute an actionable violation of ERISA's prudence requirement. If the Moench standard controls, Plaintiffs' prudence claim still loses.[73]

In In re Syncor ERISA Litigation, the Ninth Circuit again declined to adopt the Moench standard.[74] The court proceeded to apply the prudent man standard set forth in 29 U.S.C. § 1104.[75] The court explained:

> The plain language of 29 U.S.C. § 1104(a)(2) does not require fiduciaries of an eligible individual account plan to diversify their investment outside of company stock in order to meet the prudent man standard of care. However 29 U.S.C. § 1104(a)(2) does not exempt fiduciaries from the first prong of the prudent man standard, which requires a fiduciary to act with care, skill, prudence, and diligence in any investment the fiduciary chooses. A prudent man standard based only upon a company's alleged financial viability does not take into account the myriad of circumstances that could violate the standard. A violation may occur where a company's stock did not trend downward over time, but was artificially inflated during that time by an illegal scheme

[71] Id. (footnotes omitted).
[72] Id. at 1098 n.3.
[73] Id. at 1097–98 (footnotes omitted).
[74] In re Syncor ERISA Litig., 516 F.3d 1095, 1102 (9th Cir. 2008).
[75] Id.

> about which the fiduciaries knew or should have known, and then suddenly declined when the scheme was exposed. While financial viability is a factor to be considered, it is not determinative of whether the fiduciaries failed to act with care, skill, prudence, or diligence.[76]

District Court Rejects Moench in McKesson HBOC Case

In McKesson HBOC, the district court relied on Wright to grant the defendant's motion to dismiss a claim that plan fiduciaries violated their responsibilities under ERISA by failing to sell employer stock following an accounting scandal. After a detailed critique of Moench and Kuper, as well as an analysis of Wright, the court looked to the common law of trusts and general principles of statutory interpretation. The court also relied on the legislative history to section 404 of ERISA and then concluded as follows:

> By opening the door to section 404 liability, Moench places ESOP fiduciaries in an unenviable position. On the one hand, fiduciaries will face liability if they incorrectly adhere to the ESOP during an economic downturn. At the same time, fiduciaries will face liability if they unnecessarily deviate from the ESOP. Moench acknowledged this tension, but nonetheless concluded that ESOP fiduciaries "'must satisfy the demands of Congressional policies that seem destined to collide.'" Moench, 62 F.3d at 569. Yet section 404's exemptions and Congress' desire to avoid (1) "restrict[ing] investment" in company stock and (2) treating ESOPs "as conventional retirement plans" indicate that it did not intend to force ESOP fiduciaries to balance these concerns. Instead, Congress fashioned a bright-line exclusion for ESOP fiduciaries from liability for their alleged failure to sell company stock. . . . Accordingly, the court respectfully disagrees with Moench and holds that section 404 prohibits claims against fiduciaries for failing to diversify an ESOP.[77]

Following Wright and Syncor, the applicability of the Moench presumption in the Ninth Circuit is unclear. Some courts have applied both the Moench presumption of prudence and the prudent man standard.[78] In Harris v. Amgen, Inc., the court noted that although the Ninth Circuit had not yet formally adopted the Moench standard, the Circuit had declined to reject the Moench standard.[79] The court further opined that the "two Ninth Circuit cases that declined to adopt the Moench standard proceeded to apply it."[80] The court found that the "presumption of prudence may be rebutted by allegations that the fiduciaries were aware that the 'company's financial

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[76] Id.
[77] In re McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812, 828–29 (N.D. Cal. 2005) (alterations in original) (footnotes omitted).
[78] Harris v. Amgen, No. CV 07-5442, 2010 WL 744123, at *9 (C.D. Cal. March 2, 2010); In re Computer Sciences Corp. ERISA Litig, 635 F. Supp.2d 1128, 1136 (C.D. Cal. 2009).
[79] Harris v. Amgen, No. CV 07-5442, 2010 WL 744123, at *9 (C.D. Cal. March 2, 2010).
[80] Id.

condition [was] seriously deteriorating and [that] there [was] a genuine risk of insider self-dealing' or that 'the company [was] on the brink of collapse or undergoing serious mismanagement.'"[81] By contrast, in Wilson v. Venture Financial Group, Inc., the court declined to apply the Moench presumption because "the Ninth Circuit has twice declined to adopt the Moench [sic] presumption."[82]

Another District Court Rejects Moench in Delta Airlines Decision

Another district court case from the northern district of Georgia reaches the same result as the court in McKesson HBOC. In Smith v. Delta Air Lines, Inc.,[83] the court discusses and rejects the Moench line of cases in another well reasoned opinion.

Prior to its eventual bankruptcy filing, Delta incurred losses in thirteen out of fourteen quarters and lost over $6 billion. Delta's stock also declined by 92% during the relevant period of time. On the basis of these facts, plaintiff claimed that the defendants violated ERISA by continuing to offer Delta stock as an investment option and by permitting Delta to use its stock to meet its matching contribution obligations under the plan. Delta's matching contribution was made to the ESOP component of the plan.[84] Employees also could invest their own contributions in a Delta common stock fund. According to the court, the "gist" of the complaint was that the fiduciaries knew Delta was in trouble and should not have offered Delta stock as an investment option under the plan.

In 2004, approximately a year prior to its bankruptcy, Delta amended the plan to allow its investment committee to limit investments in Delta stock through the Delta common stock fund and even to eliminate the fund. The amendment also allowed the committee to appoint an investment manager, which the committee did. Shortly after its appointment, the investment manager, U.S. Trust, notified plan participants of its decision to gradually sell the Delta stock in the ESOP portion of the plan. Participants also were precluded, by way of a plan amendment, from making further investments in the Delta common stock fund. After dismissing the complaint as it applied to other defendants who had no responsibility for plan investments, the court turned its attention to the potential liability of the plan's investment committee:

> With respect to the Investment Committee, Plaintiff presents a slippery argument. Obviously cognizant of 29 U.S.C. § 1104(a)(2)'s provisions, Plaintiff does not directly allege that the Investment Committee members failed to diversify the ESOP and the Delta Common Stock Fund. Rather, Plaintiff attempts to argue around ERISA's diversification exemption by alleging that the Savings Plan's heavy investment in Delta securities was imprudent irrespective of the lack of diversification. At its core, however, Count I just amounts to another form of diversification argument.

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[81] Id. at 10 (quoting LaLonde v. Textron, Inc., 270 F. Supp.2d 272, 280 (D.R.I. 2003)).
[82] Wilson v. Venture Financial Group, Inc., No. C09-5768BHS, 2010 WL 2028088, at*6 (W.D. Wash. May 18, 2010).
[83] 422 F.Supp. 2d 1310 (N.D. Ga. 2006).
[84] Like many plans with significant employer stock components, the Delta plan designated the company stock fund as an ESOP. Id. at 1313.

> Section 1104(a)(2) speaks to such an argument, exempting not only the duty to diversify but also the duty of prudence to the extent it requires diversification. Therefore, regardless of Plaintiff's phraseology, a strict application of § 1104(a)(2) mandates dismissal of Count I as to the members of the Investment Committee.[85]

The court then discussed Moench, Kuper, Steinman, Wright, and LaLonde. Noting that the Eleventh Circuit had not yet dealt with the issue, the court held as follows:

> In the absence of controlling authority, this Court concurs with the reasoning of Wright because it more faithfully adheres to Congress's intent as provided in ERISA. The Court agrees with Wright's criticism of Moench as running afoul of ERISA's plain provisions. ERISA clearly states that in the case of EIAPs, "the diversification requirement . . . and the prudence requirement (only to the extent that is requires diversification) . . . is not violated by acquisition or holding of . . . qualifying employer securities." 29 U.S.C. § 1104(a)(2). "It is well-established that when the statute's language is plain, the sole function of the courts . . . is to enforce it according to its terms." Lamie v. United States Tr., 540 U.S. 526, 534 (2004). Yet, Moench's holding defies § 1104(a)(2), mandating diversification in certain circumstances even though ERISA plainly excuses it.
>
> Having decided to strictly construe § 1104(a)(2), the Court agrees with Defendants that Count I fails to state a claim upon which relief can be granted; "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief."[86]

The court then went on to analyze the facts at hand using the Moench standard. In this portion of its opinion, the court found that the facts in Delta were distinguishable from those in Moench. As noted above, in Moench, the fiduciaries were required to invest "primarily" in employer stock. In this case "the Investment Committee did not have the right to prohibit investment in the Delta Common Stock Fund, nor did it have the right to fund the ESOP with anything other than Delta preferred or common stock."[87] The court also commented that, in its view, the Investment Committee did not have any authority to decide whether or not to acquire Delta stock prior to the amendment of the plan in 2004.

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[85] Id. at 1327.
[86] Id. at 1330 (alterations in original).
[87] Id.

Other Cases

Pedraza v. Coca-Cola Company[88] and Mellot v. Choicepoint[89] are yet two other district court cases from the northern district of Georgia that seemingly reject the Moench approach.

In Pedraza, the plan at issue contained two investment components, one providing for the employee's choice of investment, and the other providing for a company match (the "ESOP" component).[90] The ESOP component provided that Coca-Cola would match an employee's contributions in his investment funds with the purchase of Coca-Cola stock.[91]

The plaintiffs alleged that the defendants breached their fiduciary duty under ERISA by imprudently "failing to take any action to protect participants from losses as a result of the Plan's investment in Coke stock."[92] In dismissing the plaintiffs' claim, the court opined:

> In the absence of controlling authority in the Eleventh Circuit, the undersigned finds Wright, Duke Energy, McKesson and Reliant more persuasive than cases taking the contrary view. Moench may run afoul of ERISA's express provisions. Further, the presumption/abuse of discretion formula it establishes is too broad if it is applied outside the situation where the employer is on the brink of collapse and the employees are not able to sell their stock in the plan. If any combination of factors potentially can overcome Moench's presumption, ERISA fiduciaries are left with no meaningful guidance as to when they should, or should not, ignore an ERISA plan's requirement to offer company stock. A fiduciary who decides to scrap the ESOP is just as apt to be sued as he would be if he enforced the plan provisions. This uncertainty fosters expensive, speculative litigation. It could also cause employers to be hesitant to offer the benefits of an ESOP to its employees. Furthermore, this case, like Reliant, presents a situation where the fiduciary (the Assets Management Committee) has no discretion as to investing in Coca-Cola stock where (a) the plan participant directed it or (b) the stock was purchased with Coca-Cola's matching contribution.[93]

The court further opined that Moench "would only be appropriate in the case of a company on the brink of collapse, where employee participants in the plan have no further incentive to participate."[94]

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[88] 456 F. Supp. 2d 1262 (N.D. Ga. 2006).
[89] 561 F. Supp. 2d 1305 (N.D. Ga. 2007) (vacated pursuant to settlement).
[90] Pedraza v. Coca-Cola Company, 456 F. Supp. 2d 1262, 1270 (N.D. Ga. 2006).
[91] Id.
[92] Id. at 1273 (internal citation omitted).
[93] Id. at 1275-76.
[94] Id. at 1276.

In Mellot v. Choicepoint, the district court followed Pedraza, Wright, Duke Energy, and McKesson and adopted a "strict application of § 1104(a)(2)" to end the plaintiffs' fiduciary duty claims against defendants.[95] The court found that the plaintiff's claim was essentially a "reabadged argument for diversification":

> In the absence of Eleventh Circuit authority on the issue and no clear trend among district courts, the Court finds Pedraza, Wright, Duke Energy, McKesson, and Reliant Energy, as well as Judge Evans's well-reasoned decisions in Smith and Pedraza v. Coca-Cola Co., 456 F. Supp. 2d 1262, 1274-76 (N.D. Ga. 2006) (Evans, J.), more persuasive than cases taking the contrary view. The Moench analysis potentially conflicts with ERISA's text. See Wright, 360 F.3d at 1097; In re McKesson, 391 F. Supp.2d at 825-29. In the event a company is truly on the brink of collapse and plan participants are unable to sell their company stock in the plan, Moench's approach is more tenable. See, e.g., Restatement (Second) of Trusts § 167 cmts. G, h, illus. 24 (fiduciary liable to beneficiary where due to a "change of circumstances the shares become highly speculative and it is probable as the [fiduciary] realizes that they will ultimately become worthless" and the fiduciary fails to sell the shares). However, holding fiduciaries liable based on amorphous allegations of mismanagement leaves fiduciaries with no meaningful guidance as to when they should, or should not, ignore an ERISA plan's requirement to offer company stock.[96]

This opinion was later vacated pursuant to settlement.

Finally, In re Citigroup ERISA Litigation is another more recent district court decision relying on plan language to determine whether the fiduciary was absolutely required to invest in employer securities.[97] In Citigroup, a district court in the Southern District of New York held that neither the Investment Committee nor any other plan fiduciary had a duty to override the plans' mandate that Citigroup stock be offered as an investment option.[98] The court cited various provisions of the plans[99] and noted that the "defendants had no discretion to eliminate Citigroup

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[95] Mellot v. Choicepoint, Inc., 561 F. Supp. 2d 1305 (N.D. Ga. 2007) (vacated pursuant to settlement).

[96] Id. at 1314.

[97] In re Citigroup ERISA Litig., No. 07 Civ. 9790, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009). Cf In re Washington Mutual, Inc. Securities, Derivative & ERISA Litig., No. C07-1874, 2009 WL 3246994, at *6 (W.D. Wash. Oct. 5, 2009) (looking to plan language to determine that whether the investment committee had discretionary authority to remove employer securities as an option after it had been created).

[98] Id. at 10.

[99] Section 7.01 of the Citigroup plan stated: "the Citigroup Common Stock Fund shall be permanently maintained as an Investment Fund under the Plan." The court also noted that "[e]ach plan also stipulates that the Citigroup Common Stock Fund must hold Citigroup stock, as each Plan Agreement defines the 'Citigroup Common Stock Fund' as 'an Investment Fund comprised of shares of Citigroup Common Stock.'" Id. at 7. Likewise, Section 7.01 of the Citibuilder Plan stated that "the Trustee shall maintain . . . the Citigroup Common Stock Fund."

stock as an investment option and that defendants were not acting as fiduciaries to the extent that they maintained Citigroup stock as an investment option."[100] The Citigroup court found alternatively that, even if the defendants did have discretion to eliminate Citigroup stock from among the investment options offered to plan participants, the plaintiffs failed to overcome the Moench presumption of prudence. Specifically, the court found that plaintiffs' allegations provided "'no indication' that, during the class period, Citigroup's 'viability as a going concern was ever threatened.'"[101]

The Citigroup employees have filed an appeal with the Second Circuit.

Conclusion

Returning to the questions posed in the opening paragraph, the plan fiduciary who continues to hold and purchase stock of the plan sponsor when the plan sponsor is teetering on the edge of bankruptcy will likely be found to have violated its fiduciary duty in the First, Third and Sixth Circuits. The fiduciary *might* escape liability in the Ninth Circuit and *might* also fare well with district courts that adopt the approach reflected in Delta and IPALCO Enterprises. Nevertheless, the fiduciary is assuming a significant level of risk in all jurisdictions.

If the fiduciary continues to hold and purchase stock of the plan sponsor in the face of material earnings misstatements or other improper conduct, the fiduciary likely will escape liability in the Ninth Circuit and in any court that adopts a very literal reading of section 404(a)(2). (Such as occurred in Delta, IPALCO Enterprises and McKesson HBOC). The fiduciary also will fare well in those courts in which allegations of "other improprieties" are inadequate to overcome the Moench presumption. Stated differently, if a court requires an allegation of "impending collapse," the fiduciaries should escape liability.

If the fiduciary is simply charged with holding the stock while it declines in value, and there are no "other improprieties," the fiduciary has a very good chance of avoiding liability, particularly if the plan is well drafted. Even in this situation, however, the fiduciary may not be able to bring a swift end to the litigation with a motion to dismiss, since many courts, as noted above, have found that it is inappropriate to deal with the Moench presumption at the motion to dismiss stage.

Regardless of the particular situation, plan sponsors and fiduciaries should seriously consider the approach followed by the drafters of the plan at issue in Smith v. Delta Air Lines, Inc. Arguably, all of the cases dealing with the standard that should apply in determining whether the Moench presumption can be overcome are attempting to identify those situations in which "the ERISA fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate."[102] In Delta, the employer/settlor expressly set forth its expectations on how it intended the fiduciaries to operate by amending its plan to state as follows:

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[100] Id. at 8.
[101] Id. at 19.
[102] Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).

> Notwithstanding the foregoing, the Company reaffirms its intent that . . . the Delta Stock Fund and the ESOP Stock Fund shall continue to be primarily invested in common stock of the Company and/or ESOP Preference Shares, as applicable, unless, using an abuse of discretion standard, it is clearly determined by the fiduciary with allocated responsibility for such fund that the financial collapse and bankruptcy of the Company are unavoidable . . . .[103]

The use of similar language might well help to define the standard by which the courts will assess the fiduciary's conduct.

Note: This paper is intended to provide general information. It should not be relied on as legal advice or as a legal opinion on any specific facts or circumstances. You are urged to consult legal counsel concerning your situation and any specific legal questions you may have.

[103] Smith v. Delta Air Lines, Inc., 422 F.Supp. 2d 1310, 1322 (N.D. 2006) (quoting an amendment to Delta's Savings Plan) (internal quotation marks omitted).