No. 12-10416

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

RANDY KOPP,
Individually and on Behalf of All Others Similarly Situated,
Plaintiff-Appellant,

v.

SCOTT W. KLEIN, et al.,
Defendants-Appellees,

On Appeal from the United States District Court
for the Northern District of Texas
Case No: 3:09-CV-2354-N

Brief of the Secretary of Labor as Amicus Curiae in support of the Plaintiff-Appellant

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STATEMENT OF ISSUES

This appeal stems from a class-action lawsuit that alleges that fiduciaries for defined-contribution pension plans offered by plaintiffs' employer, the Idearc Company, breached their duties under the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1001 et seq., by allowing the plans to maintain investments in Idearc's company stock when this stock was such a risky investment that a prudent fiduciary would not have held the stock as a plan investment during the relevant period. The questions that the Secretary addresses are:

1. Whether the district court erred in concluding that Plan language mandating that Idearc stock be maintained as an investment option relieved defendants, as plan fiduciaries, of their statutory duties with regard to the decision to continue offering Idearc stock as an investment option.

2. Whether the district court erred in concluding that it was proper to apply the "presumption of prudence" adopted by this Court in Kirschbaum v. Reliant Energy, Inc., 526 F.3d 243 (5th Cir. 2008), when deciding defendants' motion to dismiss the case at the pleading stage.

3. In the event that the court decides that Kirschbaum's presumption of prudence applies at the pleading stage, whether the district court erred in applying a rebuttal standard requiring a showing that the defendants possessed nonpublic information that would have alerted them that the company faced a "dire situation."

4. Whether the district court erred in dismissing plaintiffs' claim that defendants breached their fiduciary obligations by failing to disclose truthful information about the company's financial outlook and the actual risks of investing in the employer's stock when they knew or should have known that publicly available SEC filings about the company contained inaccurate and incomplete information about its financial situation.

THE SECRETARY'S INTEREST

The Secretary of Labor has primary enforcement and interpretive authority for Title I of ERISA. See, e.g., Donovan v. Cunningham, 716 F.2d 1455, 1462-1463 (5th Cir. 1983). Accordingly, the Secretary has a strong interest in ensuring that fiduciaries charged with administering employee benefit plans do so in a manner that is consistent with the fiduciary responsibilities set forth in ERISA section 404(a), 29 U.S.C. § 1104(a), and that plan participants and beneficiaries are able to enforce these duties in federal court. The Secretary similarly filed an amicus brief in the Kirschbaum case and has addressed the issues presented by this case in amicus briefs filed in a number of other circuit courts.

STATEMENT OF FACTS

Appellant Randy Kopp is a former employee of Idearc, which is one of the nation's largest providers of yellow and white page directories and related advertising products. RE 45. Idearc offered eligible employees, including Kopp,

three different ERISA plans in which they could invest their retirement income. RE 27, 42-43. The three plans merged in December 2008. RE 42. The resulting Plan is an "eligible individual account plan" ("EIAP") under ERISA. RE 132; see 29 U.S.C. § 1002(34). The Plan permitted participants to contribute and direct their contributions to one or more of the Plan's investment options, including the Idearc Company Stock Fund ("Stock Fund"), comprised of shares of Idearc common stock. RE 43, 132-33.

Throughout the class period, Idearc was the plan sponsor as well as the administrator of the Plan. RE 73. Under the Plan, the fiduciaries oversaw a number of investment options, including the Stock Fund, in which individual participants could choose to allocate their investments. RE 72, 132. Governing plan documents specified that the Stock Fund's assets "shall be invested primarily in [Idearc] common stock" and that it "will be an Investment Option until removed by a plan amendment." RE 27, 77, 133.

Before becoming a stand-alone public company, Idearc was a subsidiary of Verizon Communications, Inc. RE 27, 83-84. Verizon spun off Idearc in 2006. RE 59-60. Idearc's business involves selling advertisements in telephone directories to local and small businesses, which requires Idearc to advance credit to its customers. RE 133. After the spin-off, Idearc was heavily in debt. RE 83-84. Under an agreement executed between Idearc and Verizon, Idearc was precluded

from restructuring debt, issuing equity, merging with another company, or consolidating assets for a period of two years. RE 84. Consequently, Idearc needed to generate sufficient revenue through its operations to service the debt. RE 84. Faced with declining revenues and a plummeting stock price, Idearc filed for Chapter 11 bankruptcy on March 31, 2009. RE 28, 45, 112, 133.

During the time period that Idearc headed toward bankruptcy, Kopp, through his individual account plan, invested in the Stock Fund. RE 43-44. As set forth in the amended complaint, Kopp alleges that the defendants are fiduciaries of the Plan and that they breached various fiduciary duties under ERISA with regard to the Plan's investments in the Stock Fund. RE 43, 114, 121-29. Kopp alleges that Idearc generated insufficient revenues after the spin-off and that the company's uncollected advertising debts from its clients rose sharply due to the company's elimination of the collections staff, the company's inconsistent credit policies for returning customers, and customer confusion about billing. RE 59-62. Kopp alleges that defendants knew that Idearc stock was not a prudent investment because of the rising number of uncollected debts, and that defendants breached their fiduciary duty when they failed to act on that knowledge to protect participants' retirement savings by divesting from Idearc stock or refraining from making new purchases of Idearc stock. RE 59-68. Based on these allegations, Kopp also claims that Idearc made misleading and incomplete statements about its

financial situation in its SEC filings, RE 85-111, and that defendants, with knowledge of these statements, failed to disclose truthful material information to the participants about the company's finances. RE 122-23. As a result of defendants' breaches of fiduciary duty, Kopp claims he suffered substantial losses with regard to the Plan's investments in the Stock Fund. RE 44, 115.

STATEMENT OF THE CASE

On December 10, 2009, plaintiffs Bruce Fulmer[1] and Randy Kopp filed suit against Idearc's directors, officers, members of the Employee Benefits Committee, and members of the Human Resources Committee. RE 15, 133. Plaintiffs purported to represent a class of all current and former Plan participants whose accounts also held shares of Idearc stock anytime from November 21, 2006 through March 31, 2009 ("the class period"). RE 26, 43. Defendants filed a motion to dismiss the complaint, which the district court granted with leave for plaintiffs to amend. RE 132-42 (Fulmer v. Klein, 2011 WL 1108661 (N.D. Tex. 2011) ("Fulmer I").

Plaintiffs then filed the amended complaint that is the subject of this appeal. RE 42-131. The complaint sets forth seven causes of action for violations of fiduciary duties under ERISA, including breach of fiduciary duty by continuing to offer Idearc stock as an investment option under the Plan and failing to divest in

[1] Bruce Fulmer, the first named plaintiff before the district court, declined to participate in this appeal.

Idearc stock when the price was artificially inflated, as well as breach of the fiduciary duty of candor by making material misrepresentations and omissions bearing on a Plan benefit. RE 121-29.

Defendants again moved for dismissal. RE 21. Finding that plaintiffs failed to overcome the pleading deficiencies identified in the first decision, the district court granted defendants' motion and dismissed the complaint with prejudice. RE 26-41 (Fulmer v. Klein, 3:09-CV-2354-N (N.D. Tex. Mar. 15, 2012) ("Fulmer II")).

First, the district court concluded that defendants who lack discretion under plan documents do not have a fiduciary duty to stop offering employer stock as an investment option even when that stock becomes an imprudent investment. RE 35-37, 136. Without discretion to divest under the Plan, the court reasoned, the defendants did not have a fiduciary duty to override plan terms to do so. RE 36, 136.

Second, the district court concluded that it is appropriate to apply Kirschbaum's "presumption of prudence" at the pleading stage. RE 39-40, 141-42. In Fulmer I, the court reasoned that there is "no reason to delay [a] decision until summary judgment" when the facts alleged by plaintiffs, even if true, are insufficient to overcome the presumption. RE 141-42. In Fulmer II, the court further noted that the issue was the subject of a circuit split, but in the absence of controlling Fifth Circuit law, sided with those circuits holding that the presumption applies to the pleadings. RE 39-40.

Having decided that Kirschbaum's presumption of prudence applied to the pleadings, the district court relied on Second Circuit precedent to hold that ERISA plaintiffs are required to plead facts "show[ing] that the company was in a 'dire situation' requiring Defendants, in their fiduciary capacities, to divest." RE 38 (quoting In re Citigroup Erisa Litig., 662 F.3d 128, 140 (2d Cir. 2011), cert. pending No. 11-1531, 2012 WL 2394011 (U.S. June 22, 2012)). In Fulmer I, the court dismissed plaintiffs' claims that defendants breached their fiduciary duty of prudence by investing in and holding Idearc stock because plaintiffs failed to allege "that [d]efendants had knowledge of nonpublic information that would alert them about the imprudence of holding Idearc stock." RE 140 (court's emphasis). In Fulmer II, the court noted that plaintiffs had amended their complaint to include allegations that defendants had nonpublic information about uncollectible receivables and credit policies, but nonetheless again concluded that plaintiffs had failed to state a claim because they had not met the Second Circuit's heightened "dire situation" standard for rebutting the presumption of prudence. RE 38-39.

Finally, the district court concluded that plaintiffs failed to plead facts showing that defendants breached their "duty of candor" to provide complete and accurate information. The court found that the SEC filings upon which plaintiffs relied were not "fiduciary communications" because the summary plan description ("SPD") did not "incorporate SEC filings by reference into the SPD or direct [the]

reader to SEC filings for further information." RE 139; see also RE 33. The court further concluded that plaintiffs failed to state a nondisclosure claim because ERISA does not impose on fiduciaries an affirmative duty to disclose truthful negative information to plan participants, notwithstanding the participants' alleged exposure to the misleadingly positive information in the SEC filings. RE 33-34 (citing Kirschbaum, 526 F.3d at 256, and Citigroup, 662 F.3d at 143).

SUMMARY OF ARGUMENT

This case presents the Court with several important opportunities to clarify the "presumption of prudence" created by the Third Circuit in Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995), and adopted by this Court in Kirschbaum. The Secretary urges the Court to: (1) hold that plan language mandating that the plan offer an employer stock fund as an investment option does not excuse fiduciaries from their ERISA duties of loyalty and care under section 404, 29 U.S.C. § 1104, when those duties require overriding plan terms; (2) adopt the reasoning of the Sixth Circuit in Pfeil v. State Street Bank & Trust Co., 671 F.3d 585, 592-94 (6th Cir. 2012), and decline to transform the presumption of prudence adopted in Kirschbaum into a heightened pleading requirement; (3) clarify that the "reasonable fiduciaries" standard adopted by this Court in Kirschbaum establishes what plaintiffs need to prove to rebut the presumption of prudence and that the standard does not require the plaintiff to show the fiduciaries'

knowledge, based on nonpublic information, of an impending "dire situation"; and (4) recognize that plan fiduciaries have an affirmative duty to disclose material truthful information about the company's financial situation if they have reason to believe that the employer stock price was inflated or participants may have been misled by inaccurate or overly optimistic statements in the company's public SEC filings. Reversing the district court on these grounds would serve to restore balance to the competing goals identified by this Court in Kirschbaum: "protection of employee benefits" and Congress's "preference for plan investment in the employer's stock." 526 F.3d at 253.

ARGUMENT

I. THE DISTRICT COURT'S DISMISSAL OF THE FIDUCIARY BREACH CLAIMS BASED ON THE PRESUMPTION OF PRUDENCE SHOULD BE REVERSED

A. The Plan Language Mandating the Idearc Investment Option Did Not Excuse the Plan Fiduciaries From Their Duties to Act Prudently, Loyally, and Solely in the Interest of the Plan Participants and Beneficiaries

Consistent with its central purpose to protect beneficiaries of employee benefit plans, section 404 of ERISA imposes upon all fiduciaries the duties to act exclusively in the interests of the participants and beneficiaries and to exercise the level of "care, skill, prudence, and diligence . . . that a prudent man acting in a like capacity and familiar with such matters would use." 29 U.S.C. § 1104(a)(1)(A)-(B). As a corollary, fiduciaries have a duty to override plan terms if following

those terms would violate the duties of loyalty and prudence imposed by ERISA sections 404(a) and (b), 29 U.S.C. §§1104(a), 1104(b). See 29 U.S.C. § 1104(a)(1)(D) (stating that fiduciaries must act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of [Titles I and IV of ERISA]."). A fiduciary must therefore comply with those duties even when plan documents instruct them to invest in employer stock.

Sections 402(a)(1), 403(a), and 410 of ERISA further support reading section 404 to impose duties of care and loyalty even when fiduciaries have little or no discretion under plan documents. Section 402(a)(1) provides that plans must be maintained pursuant to plan documents that provide for "one or more named fiduciaries who jointly or severally shall have authority to control and manage the operation of the plan." 29 U.S.C. § 1102(a)(1). Similarly, ERISA section 403(a) mandates that "all assets of an employee benefit plan shall be held in trust by one or more trustees" who "have exclusive authority and discretion to manage and control the assets of the plan," subject only to the proper direction of the named trustee where the plan so provides. 29 U.S.C. § 1103(a) (emphasis added). And ERISA section 410, 29 U.S.C. § 1110, "void[s] as against public policy" "any provision in an agreement or instrument which purports to relieve a fiduciary from

responsibility or liability for any responsibility, obligation, or duty under this part," subject to a right to secure liability insurance.

Under these statutory provisions it is clear that plan documents can allocate, but not eliminate, fiduciary duties with respect to ERISA plans and the management of their assets. No plan can be on auto-pilot with no fiduciary having the requisite discretionary authority and control to conform plan conduct to statutory requirements in accordance with the high standards demanded of everyone in that position of trust. See 29 U.S.C. § 1002(21)(a) (defining "fiduciary"). Thus, plan language mandating that the plan offer an employer stock fund as an investment option does not excuse fiduciaries from their ERISA duties of loyalty and care.

Every circuit to decide the issue has recognized that plan language mandating investment in company stock does not immunize the fiduciaries from exercising their fiduciary duty with respect to that stock. See Citigroup, 662 F.3d at 139 (rejecting rule that investment instructions in a plan document can shield defendants from liability because such a rule "would leave employees' retirement savings that are invested in ESOPs or EIAPs without any protection at all – a result that Congress sought to avoid in enacting ERISA"); Kuper v. Iovenko, 66 F.3d 1447, 1457 (6th Cir. 1995) ("[T]he purpose of ESOPs cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit

plans."); see also In re Syncor ERISA Litig., 516 F.3d 1095, 1102-03 (9th Cir. 2008); Fink v. Nat'l Savings & Trust Co., 772 F.2d 951, 955-56 (D.C. Cir. 1985); Eaves v. Penn, 587 F.2d 453, 459 (10th Cir. 1978).

Moreover, the Fifth Circuit has decided two cases that, taken together, establish the same principle. This Court has unequivocally held that ERISA's requirements override inconsistent plan terms. See Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, 173 F.3d 313, 322 (5th Cir. 1999) ("A fiduciary may not discharge his duties in a manner inconsistent with ERISA provisions. . . . In case of a conflict, the provisions of the ERISA policies as set forth in the statute and regulations prevail over those of the Fund guidelines."). It has also held that section 404's duties of care and loyalty apply equally to cases involving plan investments in employer stock funds. See Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983) ("ESOP fiduciaries remain subject to the general requirements of [s]ection 404."). These authorities militate reversal of the district court's conclusion that the mandatory nature of the Plan's employer stock investment option inoculated fiduciaries from any fiduciary duty whatsoever for continuing to offer such an option.

Finally, although Kirschbaum explicitly declined to decide this issue, see 526 F.3d at 253, nothing in that decision undermines those precedents, nor does it prevent the Court from holding here that plan language mandating an employer

stock investment option does not excuse plan fiduciaries from their ERISA duties of care and loyalty. Rather, the Court in Kirschbaum implicitly assumed the possibility that ERISA's fiduciary duties could in some circumstances trump plan language mandating investment in company stock. Id. (adopting the Moench "presumption of prudence" to decide "when the duty of prudence might require a fiduciary to disobey the clear requirements of an EIAP") (emphasis added).

Thus, the district court erred when it concluded that "[d]efendants had no discretion and consequently no fiduciary duty to stop offering Idearc stock." RE 35-37, 137-38. The Court should hold, instead, that defendants had both discretion to override the plan terms directing investment in employer stock and a fiduciary duty to do so if the ERISA prudence standard so required.

B. The Presumption of Prudence Adopted in Kirschbaum Does Not Apply to a Motion to Dismiss on the Pleadings

1. In Kirschbaum, this Court considered an appeal from summary judgment in an employee stock ownership case. Id. at 246. Plaintiffs alleged that defendants breached their fiduciary duties by failing to liquidate the employee stock fund and by failing to stop purchasing shares of company stock because the stock was an imprudent investment. Id. Defendants should have known the investment was imprudent, they asserted, because defendants knew that employees had been engaging in sham energy trades to bolster the appearance of the company's financial health. Id. at 247. The district court granted defendants' summary

judgment motion on the ground that the defendants lacked discretionary control over the plan, and this Court affirmed, though on different reasoning. The Court declined to "definitively resolve" the extent to which ERISA required the defendants to override plan terms. Id. at 253. Instead, it adopted the presumption of prudence and then held that plaintiffs had failed to overcome the presumption. Id. at 253-56. To overcome the presumption of prudence, the Court said, "there ought to be persuasive and analytically rigorous facts demonstrating that reasonable fiduciaries would have considered themselves bound to divest." Id. at 256.

The "presumption of prudence" adopted in Kirschbaum thus affords a fiduciary the benefit of "a rebuttable presumption [not available for other fiduciary acts] that his decision to invest in the employer's securities was prudent" under section 404. Kirschbaum, 526 F.3d. at 254. The exact scope of the presumption, however, has yet to be decided.

Other courts of appeals have reached conflicting conclusions regarding the standards governing the obligations of ERISA fiduciaries who invest in employer stock – in particular, what a plaintiff must plead or prove to rebut the presumption of prudence. The Fourth, Sixth, and District of Columbia Circuits have articulated a standard closely tied to ERISA's statutory prudence standard, whereas the Second, Third, Ninth, and Eleventh Circuits have created a higher rebuttal standard

requiring that plaintiffs show a "dire situation," a "precipitous decline in the employer's stock," or that the company is on the "brink of collapse."[2] The courts of appeals have also diverged regarding whether it is appropriate to apply the presumption when evaluating a motion to dismiss. The Sixth Circuit has declined to apply the presumption at the pleading stage, whereas the Second and Eleventh

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[2] Compare Pfeil v. State Street Bank & Trust Co., 671 F.3d 585, 591-92 (6th Cir. 2012) (rebuttal standard "requires a plaintiff to prove that 'a prudent fiduciary acting under similar circumstances would have made a different investment decision'"); DiFelice v. U.S. Airways, 497 F.3d 410, 422 (4th Cir. 2007) (quoting ERISA's prudence standard in 29 U.S.C. § 1104(a)(1)(B) as the "only test of a fiduciary's duties"); and Fink v. Nat'l Savings & Trust Co., 772 F.2d 951, 955-56 (D.C. Cir. 1985) ("The investment decisions of a profit sharing plan's fiduciary are subject to the closest scrutiny under the prudent person rule, in spite of the strong policy and preference in favor of investment in employer stock.") (internal quotation marks omitted), with Lanfear v. Home Depot, Inc., 2012 WL 1580614, at *10-*11 (11th Cir. 2012) ("a fiduciary abuses his discretion by acting in compliance with the directions of the plan only when the fiduciary could not have reasonably believed that the settlors would not have intended for him to do so under the circumstances"); Citigroup, 662 F.3d at 140 ("[O]nly circumstances placing the employer in a 'dire situation' that was objectively unforeseeable by the settlor could require fiduciaries to override plan terms."); Quan v. Computer Sciences Corp., 623 F.3d 870 (9th Cir. 2010) ("To overcome the presumption of prudent investment, plaintiffs must make allegations that clearly implicate the company's viability as an ongoing concern or show a precipitous decline in the employer's stock combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement."); and Edgar v. Avaya, 503 F.3d 340, 348 (3d Cir. 2007) (requiring "type of dire situation which would require defendants to disobey the terms of the Plans by not offering" the employer stock, while rejecting "brink of bankruptcy" rebuttal standard). See generally Petition for Writ of Certiorari, Gray v. Citigroup, Inc., No. 11-1531, 2012 WL 2394011 (U.S. Jun. 22, 2012), at *15-18 (discussing circuit conflict on rebuttal standard).

Circuits have relied on the presumption when affirming the dismissal of a complaint.[3]

The Secretary argued in Kirschbaum and in other courts against the adoption of a presumption of prudence not found in the statutory text. Kirschbaum settled the question of whether to adopt some version of the presumption in this Court, but left open the other, subsidiary questions presented by this case. Here, therefore, the Secretary urges the Court to refine the limits of the presumption to better balance the competing goals identified by this Court in Kirschbaum: "protection of employee benefits" and Congress's "preference for plan investment in the employer's stock." 526 F.3d at 253. So long as a plan's inclusion of employer stock as a mandatory investment option entitles fiduciaries to a presumption of prudence, the Court should, consistent with both congressional intent and Supreme Court precedent cautioning courts from rewriting ERISA's statutory text, limit the presumption's effect on fiduciary conduct to assure that, as much as possible, the

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[3] Compare Pfeil, 671 F.3d at 592-93 (holding that the presumption is "an evidentiary presumption, and not a pleading requirement . . . As such, a plaintiff need not plead enough facts to overcome the presumption in order to survive a motion to dismiss."), with Lanfear, 2012 WL 1580614, at * 11 ("The Moench standard of review . . . applies at the motion to dismiss stage."), and Citigroup, 662 F.3d at 139 ("The 'presumption' is not an evidentiary presumption; it is a standard of review applied to a decision made by an ERISA fiduciary."). See also Edgar, 503 F.3d at 349 (presumption applicable to motion to dismiss). See generally Petition for Writ of Certiorari, Gray v. Citigroup, Inc., No. 11-1531, 2012 WL 2394011 (U.S. Jun. 22, 2012), at *18-20 (discussing circuit split on nature of presumption).

goal of promoting investment in employer's stock does not eclipse ERISA's primary commitment to protection of employee benefits. See Mertens v. Hewitt Assocs., 508 U.S. 248, 259 (1993) ("The authority of courts to develop a 'federal common law' under ERISA . . . is not the authority to revise the text of the statute.").

2. The district court erred when it prematurely applied the "presumption of prudence" to plaintiffs' motion to dismiss. As the Sixth Circuit recently held in Pfeil, 671 F.3d at 592-94, the presumption of prudence is "an evidentiary presumption, and not a pleading requirement. . . . As such, a plaintiff need not plead enough facts to overcome the presumption in order to survive a motion to dismiss." Id. at 593 (citing Swierkiewicz v. Sorema N.A., 534 U.S. 506, 510 (2002)). Nothing in Kirschbaum, which (like Moench itself) was decided on summary judgment, see 526 F.3d at 246, states otherwise or even addresses this issue.

To be sure, there is a conflict in the circuits on this question. See note 4, supra. Such conflict is not surprising given that the presumption is a judicially created construct not directly tied to the statutory text. For the reasons stated below, however, Pfeil is the best reasoned of these decisions and the one most consistent with general legal principles.

Courts use pleading standards to decide "whether the claimant is entitled to offer evidence to support" the allegations in the complaint. Swierkiewicz, 534 U.S. at 511 (quoting Scheuer v. Rhodes, 416 U.S. 232, 236 (1974)). In contrast, courts use evidentiary standards to determine "the order and allocation of proof" the parties must use to support or rebut the factual allegations made. Id. at 510. The former is concerned with the sufficiency of the alleged facts, the latter with the sufficiency of the proffered evidence.

Because courts assess and weigh the evidence when applying evidentiary standards, such standards are typically not applied until summary judgment or trial. Dismissals based on evidentiary standards therefore have no place at the pleading stage, where the court must assume the veracity of the facts alleged. See Pfeil, 671 F.3d at 593 ("Precisely because the presumption of reasonableness . . . concerns questions of fact, applying the presumption at the pleadings stage . . . would be inconsistent with the Rule 12(b)(6) standard."); see also Ashcroft v. Iqbal, 556 U.S. 662, 659 ("When there are well-pleaded factual allegations, a court should assume their veracity and then determine whether they plausibly give rise to an entitlement to relief.").

As formulated by the courts, the presumption of prudence is by its nature an evidentiary presumption that tips the scales in favor of the defendant unless the plaintiff can successfully rebut it. Even though Kirschbaum describes the Moench

presumption as an "abuse of discretion standard of review," 526 F.3d at 254, that characterization does not require the application of the presumption to the pleadings. In the same discussion, the Court also makes clear that a plausible dispute over the prudence of the fiduciary's conduct in light of the circumstances presents a "triable question" of fact. Id. A "triable question" necessarily involves weighing the evidence – making application of the presumption before any discovery occurs inappropriate. Kirschbaum also tellingly uses other language pointing to the presumption being an evidentiary standard. See id. at 254-56 (using terms such as "rebut," "show," "heavier burden of showing," and "factfinder"). These textual and contextual clues suggest that Kirschbaum's presumption is an evidentiary standard that is inapplicable at the pleading stage.

Moreover, even if viewed as an "abuse of discretion" standard of review, it is still only reasonable to expect that ERISA plaintiffs will obtain the necessary rebuttal evidence during discovery. See Braden v. Wal-Mart Stores, Inc., 588 F.3d 585 (8th Cir. 2009) (reversing district court's dismissal of ERISA claim before discovery into fiduciary conduct). Under Federal Rule of Civil Procedure 8, plaintiffs need not "plead 'specific facts' explaining precisely how the defendant's conduct was unlawful." Id. at 595. "Rather, it is sufficient for a plaintiff to plead facts indirectly showing unlawful behavior, so long as the facts pled give the defendant fair notice of what the claim is and the grounds upon which it rests, and

allow the court to draw the reasonable inference that the plaintiff is entitled to relief." Id. (internal citations, quotations, and alterations omitted). The rules do not place an overly exacting burden on plaintiffs because evidence of the fiduciary's knowledge is typically in the possession of the defendants rather than plaintiffs before discovery begins. Id. at 598. ("No matter how clever or diligent, ERISA plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery commences."). Although Braden was not an employer stock case implicating the presumption of prudence (which the Eight Circuit has yet to address), the reasoning of the Eighth Circuit for overturning a dismissal of ERISA fiduciary breach claims at the pleading stage applies equally in this context.

To the extent that other circuits have held that characterizing the presumption of prudence as a "standard of review" requires the presumption's application at the pleading stage, they have saddled plaintiffs with a burden that exceeds the pleading requirements of the Federal Rules of Civil Procedure. The Secretary therefore urges this Court, consistent with the reasoning of the Eighth Circuit, to join the Sixth Circuit in declining to transform the presumption of prudence into a heightened pleading requirement.

C. The District Court Applied the Wrong Rebuttal Standard

Even if the Court concludes that a plaintiff must plead around the presumption of prudence to survive a motion to dismiss, the Court should reject the district court's rebuttal standard requiring a showing of a "dire situation" to establish imprudence, as well as its requirement for plaintiffs to allege that fiduciaries had knowledge of nonpublic information that would alert them about the imprudence of holding Idearc stock. See RE 38, 140.

The district court's standard requiring allegations of nonpublic information to establish a "dire situation" misperceives the nature of ERISA prudence. Under ERISA's prudent man standard, prudence is required in all circumstances, not just when the company is on the brink of collapse; and it is measured by what a reasonable fiduciary would do in like circumstances, not by whether the source of the fiduciary's knowledge was publicly available or insider information. See 29 U.S.C. § 1104(a)(1)(B).

Kirschbaum does not require the rebuttal standard used by the district court. Kirschbaum initially states that a plaintiff must show that "unforeseen circumstances would defeat or substantially impair the accomplishment of the trust's purposes." 526 F.3d at 256; see also id. at 254 (apparently agreeing with Moench that "[a] plaintiff may rebut the presumption only by showing that 'owing to circumstances not known to the settlor and not anticipated by him [the making

of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust'") (quoting Moench, 62 F.3d at 571)). It then explains, however, that ultimately rebuttal depends on whether "reasonable fiduciaries would have considered themselves bound to divest." 526 F.3d at 256.

Of these two seemingly different standards – the "unforeseen circumstances" standard and the "reasonable fiduciary" standard – the reasonable fiduciary standard more closely hews to ERISA's statutory prudent man standard. See 29 U.S.C. § 1104(a)(1)(B); Pfeil, 671 F.3d at 595 ("The rebuttal standard in this Circuit . . . requires a plaintiff to prove that a prudent fiduciary acting under similar circumstances would have made a different investment decision.") (internal quotation marks omitted). Indeed, the "unforeseen circumstances" standard conflicts with ERISA's text to the extent it suggests that the employer may create an ERISA plan with license to ignore the prudence of its investments. However important settlor intent may be to construction of a common-law trust, the plan sponsor's intent must yield to ERISA's requirement that fiduciaries administering ERISA plans act "solely in the interest of the participants and beneficiaries" and with "care, skill prudence, and diligence," 29 U.S.C. §§ 1104(a)(1), 1104(a)(1)(B). These statutory requirements, along with ERISA's mandate that the fiduciary only follow plan terms that are consistent with the statute's requirements, 29 U.S.C. § 1104(a)(1)(D), make the plan sponsor's original intent subordinate to the question

of whether a fiduciary has breached his duties under ERISA. See also ERISA section 410, 29 U.S.C. § 1110 (invalidating, as against public policy, any instruments purporting to relieve fiduciaries from their responsibilities under Title I).

In any event, Kirschbaum was clear in stating that "[w]e do not hold that the Moench presumption applies only in the case of investments in stock of a company that is about to collapse." 526 F.3d at 256. This Court should likewise reject the slightly less drastic "dire situation" standard because that standard, like the "unforeseen circumstances" standard, is absent from, and at odds with, ERISA's text. ERISA neither refers to "dire situations" nor suggests that the fiduciary duty of prudence is an obligation merely to protect participants from disastrous losses, while ignoring other risks of serious injury. To adopt this diminished standard of prudence would be to disregard Supreme Court precedent prohibiting the courts from using federal common law to rewrite the text of ERISA. Mertens, 508 U.S. at 259. It would also give short shrift to Kirschbaum's more exacting "reasonable fiduciaries" standard.

It would be particularly inappropriate to insist on a "dire situation" test where, as here, the plaintiffs allege that the defendants caused the Plan to continue to buy the stock at prices that were artificially inflated by misstatements to the public about Idearc's financial situation. Knowingly overpaying for an asset is neither prudent nor in the interest of plan participants and beneficiaries. See, e.g.,

Martin v. Feilen, 965 F.2d 660, 671 (8th Cir. 1992). This follows from the well-established rule that a fiduciary breaches his duties by knowingly paying too much for an asset for the plan. See Feilen, 965 F.2d at 671; Restatement (Third) of Trusts § 205 cmt. e, illus. 9 (1959). Whether the plan gets nothing in return for its payment or too little, the breach is the same. Cf. U.S. Dep't of Labor Field Assistance Bulletin 2004-03 (Dec. 17, 2004) ("if a directed trustee has non-public information indicating that a company's public financial statements contain material misrepresentations that significantly inflate the company's earnings, the trustee could not simply follow a direction to purchase that company's stock at an artificially inflated price"); In re Halpin, 566 F.3d 286, 290 n.2 (2d Cir. 2009) (applying Skidmore deference to Field Assistance Bulletins).

Finally, the district court's requirement that plaintiffs allege that fiduciaries had knowledge of nonpublic information that would alert them about the imprudence of holding Idearc stock was also erroneous. "Reasonable fiduciaries" could consider themselves "bound to divest" by either public or nonpublic information: the relevant question is what impact the information is likely to have on the participants' retirement assets in the future. Fiduciaries are not relieved of their duty to act prudently and loyally based on all the information available to them just because the public (including participants) have access to the same information; rather, they are expected to have specialized expertise and experience

commensurate with the position of trust they assume as fiduciaries. See Bussian v. RJR Nabisco, Inc., 223 F.3d 286, 294 (5th Cir. 2000) ("ERISA's duty of loyalty is 'the highest known to the law.'") (citation omitted). In any event, plaintiffs did allege nonpublic knowledge here, including knowledge of the company's rising debt levels and the existence of conditions that would exacerbate the company's cash flow problems. See RE 59-69, 83-112.

Accordingly, the Secretary urges the Court to clarify that the "reasonable fiduciaries" standard adopted in Kirschbaum is the controlling rebuttal standard and that it does not require the plaintiff to show that the fiduciaries had nonpublic knowledge of an impending "dire situation." As in the Sixth Circuit, the standard should be whether "a prudent fiduciary acting under similar circumstances would have made a different investment decision with respect to [the employer stock]." Pfeil, 671 F.3d at 595.

II. THE DISTRICT COURT'S DISMISSAL OF THE NONDISCLOSURE CLAIM SHOULD BE REVERSED

The district court correctly determined that that the SPD did not incorporate Idearc's SEC filings by reference and that the securities filings themselves were not made in a fiduciary capacity. See RE 33. The district court erred, however, in concluding that this fact precluded plaintiffs' claim that ERISA required the plan fiduciaries to disclose material truthful information to participants. See RE 33-34.

ERISA fiduciaries' duty to disclose originates in the law of trusts. Martinez v. Schlumberger, Ltd. 338 F.3d 407, 412 (5th Cir. 2003). Under the trust law, beneficiaries are "always entitled to such information as is reasonably necessary to enable [them] to enforce [their] rights under the trust or to prevent or redress a breach of trust." Restatement (Second) of Trusts § 173, cmt. c-d (1959); see also Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Sec., Inc., 93 F.3d 1171, 1180 (3d Cir. 1996).

The Supreme Court has made clear that ERISA's fiduciary duties prohibit fiduciaries from misinforming beneficiaries. See Varity Corp. v. Howe, 516 U.S. 489, 506 (1996). ERISA's fiduciary duties under section 404(a) also require fiduciaries to protect participants and beneficiaries from harm by affirmatively disclosing material information that plan participants need to know to adequately protect their interests. McDonald v. Provident Indemnity Life Ins. Co., 60 F.3d 234, 237 (5th Cir. 1995) ("An obvious component of [fiduciary] responsibilities is the duty to disclose material information."); accord Bixler v. Cent. Penn. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993) ("This duty to inform . . . entails not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful.").

This Court takes a "case by case" approach to the question of when circumstances compel fiduciaries to affirmatively disclose material information,

finding such duties in "special circumstance[s]," such as when concealed information could cause an "extreme impact" to plan participants and beneficiaries. Ehlmann v. Kaiser Found. Health Plan of Tex., 198 F.3d 552, 556 (5th Cir. 2000); In re Enron Corp. Sec. Litig., 284 F. Supp. 2d 511, 559 (S.D. Tex. 2003).

Kopp pleaded such "special circumstances" here when he alleged that the fiduciaries possessed material, adverse information regarding Idearc's financial condition and stock, and that the market value of the stock was artificially inflated because this information had not been disclosed. See Citigroup, 662 F.3d at 159 (Straub, J. dissenting) (analogizing to this Court's McDonald decision in employer stock case). The fact that Kopp plausibly alleges that the company's SEC filings contained misleading, excessively optimistic statements about Idearc's financial situation, and that the defendants knew or should have known this, supports his nondisclosure claim by reinforcing the need for truthful information to counter the effects of widely available inaccurate information.

A fiduciary who knows that the market price is artificially inflated because of the nondisclosure of material information should not be permitted to stand idly by if he knows that plan participants are being misled. See, e.g., Department of Labor, Field Assistance Bulletin 2004-03, Fiduciary Responsibilities of Directed Trustees (Dec. 17, 2004), available at http://www.dol.gov/ebsa/egs/fab2004-3.html. Rather, a fiduciary with such knowledge should take some action – stop

purchasing employer stock, insist that the issuer of the stock disclose the material information to the public, or disclose the information to the public directly – to protect the interests of the plan participants and beneficiaries. See Enron, 284 F. Supp. 2d at 566. Taking any of these steps to protect retirement benefits would not "convert[] fiduciaries into investment advisors" Lanfear, 679 F.3d at 1285, or violate insider trading rules. See id. at 1285-86.

The Secretary therefore urges the Court to reverse the district court's dismissal of the nondisclosure claim.

CONCLUSION

For the foregoing reasons, the Secretary respectfully requests that the Court reverse the district court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH RULE 32(a)

This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 6,600 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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CERTIFICATE OF SERVICE

I hereby certify that on the 15th day of August, 2012, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF systems.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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