No. 09-3804-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: CITIGROUP ERISA LITIGATION [09-3804-cv]

Stephen Gray, James Bolla and Samier Tadros,
Lead Plaintiffs-Appellants,

Sandra Walsh, Anton K. Rappold, and Alan Stevens,
Plaintiffs-Appellants,

v.

(For Continuation of Caption See Inside Cover)

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF AMICUS CURIAE,
SECRETARY OF LABOR
IN SUPPORT OF APPELLANTS' PETITION FOR
PANEL OR EN BANC REHEARING

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- v -

Citigroup Inc., Citibank, N.A., The Plans Administration Committee, The Plans Investment Committee, Charles O. Prince, Robert E. Rubin, Jorge Bermudez, Michael Burke, Steve Calabro, Larry Jones, Faith Massingale, Thomas Santangelo, Alisa Seminara, Richard Tazik, James Costabile, Robert Grogan, Robin Leopold, Glenn Regan, Christine Simpson, Timothy Tucker, Leo Viola, Donald Young, Marcia Young, and John Does 1-20,

Defendants-Appellees.

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BACKGROUND AND INTEREST OF THE SECRETARY

Petitioners seek rehearing of the decisions in these companion cases brought under the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001 et seq., by participants in pension plans sponsored by Citigroup and McGraw-Hill. In both cases, participants allege that plan fiduciaries failed to comply with their statutory duty of prudence with respect to billions of dollars of plan investments in employer stock. The companies allegedly misled plan and public investors about the companies' exposure to potentially catastrophic risks in the subprime mortgage market in which they played central roles – in Citigroup's case, as a market participant with huge undisclosed investments in subprime lending and in McGraw-Hill's case (through S&P), as a rating agency knowingly and systematically overstating the value of mortgage-backed securities. Heedless of the risks to plan participants, and despite their status as allegedly knowledgeable corporate insiders, the fiduciaries allegedly took no action to protect participants from apparent danger. Instead, they continued to buy stock for the plans at prices that were artificially inflated by market fraud while doing nothing to warn participants of the risks posed by the companies' conduct.

Despite the fact that the fiduciaries were duty bound by ERISA to operate under a standard of care that is, as this Court long-ago recognized, the "highest known to the law," Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir. 1982),

the panel concluded that even if the plaintiffs' allegations were true, the fiduciaries had no obligation to do anything to protect the plans' participants. Thus, the panel held that neither the fiduciaries' purported awareness "of the impending collapse of the subprime-mortgage market," nor the allegation that they "failed to investigate the continued prudence of investing in Citigroup stock," nor the allegedly foreseeable loss of "tens of billions of dollars" in Citigroup's value, nor the allegations that "Citigroup's stock price was 'inflated' during the Class Period because the price did not reflect the company's true underlying value" sufficed to state a claim for fiduciary breach. In re Citigroup ERISA Litig., 2011 WL 4950368, at *9, *10 (2d Cir. Oct. 19, 2011). In the panel's view, even if the fiduciaries had investigated or otherwise knew the true facts at the company, they would not have breached their duties because they were not "compelled to conclude . . . that Citigroup was in the sort of dire financial situation that required them to override Plan terms in order to limit participants' investments in Citigroup stock." Id. at *10. Nor, according to the panel, did the fiduciaries have an affirmative duty to disclose nonpublic information about the company's stock to the plan participants and other investors as a means of protection. Id. at *11.

In reaching its holdings, the panel did not apply the prudence standard expressly set forth in ERISA's text – a fiduciary obligation to act in accordance with the trust law's stringent prudent man standard. 29 U.S.C. § 1104(a)(1)(B).

Under the statutory test, dismissal would not be appropriate because one could not plausibly conclude that a prudent person "acting in a like capacity and familiar with such matters" would have knowingly overpaid for stock and failed to take any action whatsoever to protect plan participants' from the clear dangers presented. The panel, however, following the lead of a number of other Circuits, adopted a "presumption of prudence" so stringent that even the allegations above were insufficient to trigger an obligation to do anything to protect plan participants.[1]

The panel's holdings render ERISA's fiduciary protections illusory in the context of publicly-traded employer stock in all but the most "dire situations," "a standard that the majority neglects to define in any meaningful way." 2011 WL 4950368, at *15 (Straub, J., dissenting). Its adoption of a presumption of prudence for employer stock investments finds no support in the text of this "comprehensive and reticulated statute," Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 146 (1985), which 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.

The panel's endorsement, on policy grounds, of a diminished standard of prudence disregards Supreme Court cases prohibiting the courts from using federal

[1] 2001 WL 4950368, at *6 (citing Moench v. Robertson, 62 F.3d 553, 568 (3d Cir. 1995); Kuper v. Iovenko, 66 F.3d 1447, 1451 (6th Cir. 1995); Kirschbaum v. Reliant Energy, In., 526 F.3d 243, 254 (5th Cir. 2008); Quan v. Computer Scis. Corp., 623 F.3d 870, 881 (9th Cir. 2010).

common law to rewrite the text of ERISA and gives short shrift to the exacting standard of prudence previously imposed on plan fiduciaries in this Circuit. And although the panel concluded that the plaintiffs' factual allegations were too conclusory to support a finding that the defendants had actual knowledge of the companies' subprime exposure, the broad application of the presumption would preclude liability even for the knowing overpayment for employer stock except in the rare case where the fiduciaries are "compelled to conclude that [the company] was in a dire situation." 2011 WL 4950368, at *10. The decision thus undermines ERISA's protections and disregards uniform case law recognizing that fiduciaries breach their duties by overpaying for plan investments. Likewise, the panel's rejection of the well-recognized fiduciary duty to disclose needed information to plan participants – apparently even in "dire situations" – contradicts both the trust law and the uniform law of the many other circuits that have considered the issue.

The Secretary of Labor, who has primary authority for enforcing and administering Title I of ERISA, 29 U.S.C. §§ 1002(13), 1136(b), agrees with the dissent that the panel's holdings represent "both an alarming dilution" of ERISA "and a windfall for fiduciaries, who may now avail themselves of the corporate benefits of employee stock ownership plans (ESOPs) without the costs of complying with the statutorily mandated obligations of prudence." 2011 WL 4950368, at *15 (Straub, J., dissenting). The issues are of exceptional importance

under Federal Rules of Appellate Procedure 35(a)(2) and (b)(1)(B) because they put hundreds of billions of dollars in pension plan assets at undue risk.

ARGUMENT

I. A PRESUMPTION OF PRUDENCE FINDS NO SUPPORT IN, AND INDEED CONFLICTS WITH, ERISA'S STATUTORY TEXT AND PURPOSES, AND LEADS TO ABSURD RESULTS

Nothing in ERISA supports the application of a presumption of prudence to investments in employer stock by retirement plans. Consistent with its "central purpose [] 'to protect beneficiaries of employee benefit plans,'" Citigroup, 2011 WL 4950368, at *5 (citation omitted), ERISA imposes upon all fiduciaries the duties to act exclusively in the interests of the participants and beneficiaries and to 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 a like character and with like aims." 29 U.S.C. §§ 1104(a)(1)(A) & (B); S. Rep. No. 93-127, 1974 U.S.C.C.A.N. 4838, 4863, 4866 ("the core principles of fiduciary conduct . . . place a . . . duty on every fiduciary: to act in his relationship to the plan's fund as a prudent man in a similar situation and under like conditions would act") (emphasis added). At a minimum, these duties require "a review of the fiduciary's independent investigation of the merits of a particular investment." Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983); Katsaros v. Cody, 744 F.2d 270, 279 (2d Cir. 1984) ("[t]he court's task

is to inquire 'whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment'") (citation omitted).

There is no basis in ERISA for a special, less exacting obligation to prudently evaluate and structure plan investments in employer stock. While the Act exempts certain investments in employer securities from ERISA's diversification requirement, it expressly limits the scope of the carve-out – fiduciaries are relieved from the "prudence requirement (only to the extent that it requires diversification)," id. § 1104(a)(2) (emphasis added).[2] Thus, ERISA fiduciaries must otherwise manage employer securities under the statute's exacting standard of care. See DiFelice v. U.S. Airways, Inc., 497 F.3d 410, 422-23 (4th Cir. 2007) (rejecting a four-part test of fiduciary duty with regard to investments in employer securities and holding, instead, that "ERISA itself sets forth the only test of a fiduciary's duties") (emphasis added). Rather than rely on the text of ERISA's prudence provision, however, the panel's opinion relied on two policy concerns that it believed were in tension with the duty of prudence: "(1) the Plan language mandating that the Stock Fund be included as an investment option and (2) the

[2] In those few instances where the statute exempts fiduciaries from their duty to act prudently, it does so expressly. E.g., Eastman Kodak Co. v. STWB, Inc., 452 F.3d 215, 217 (2d Cir. 2006) (ERISA exempts "top-hat" plans from fiduciary requirements); Gilliam v. Nev. Power Co., 488 F.3d 1189, 1192-93 (9th Cir. 2007) (fiduciary exemption of top-hat plans was "no small matter"… and "Congress created a special regime to cover them") (citation omitted).

'favored status Congress has granted to employee stock investments in their own companies.'" 2011 WL 4950368, at *5 (citation omitted). Neither concern supports the presumption.

As to the former concern, the statute expressly addresses situations where plan documents conflict with statutory duties, and states that the duties set forth in the Act trump plan language. Far from imposing "competing obligations" on fiduciaries, id. at *7, the statute clearly provides that fiduciaries must follow plan documents only "insofar as such documents and instruments are consistent with [title I and IV of ERISA]." 29 U.S.C. § 1104(a)(1)(D); Cent. States, Se. and Sw. Areas Pension Fund v. Cent. Trans., Inc., 472 U.S. 559, 568 (1985) ("trust documents cannot excuse trustees from their duties under ERISA"); Esden v. Bank of Boston, 229 F.3d 154, 173 (2d Cir. 2000) ("[t]he Plan cannot contract around the statute"). See also 29 U.S.C. § 1110 (any plan documents that reduce liability for fiduciary breaches are "void as against public policy"). The legislative history is also clear on this point, explaining that, unlike the trust law, ERISA bars "deviations" from fiduciary duties based on plan language. S. Rep. No. 93-127, 1974 U.S.C.C.A.N. at 4866; H.R. Rep. No. 93-533, 1974 U.S.C.C.A.N. 4639, 4650 (noting that ERISA departs from the trust framework – which permitted "investments which might otherwise be considered imprudent" based on the settlor's expressed intent to allow such investments – because "the typical

employee benefit plan, covering hundreds or even thousands of participants, is quite different from the testamentary trust both in purpose and nature").

Thus, the panel's conclusion that only "in a 'dire situation' that was objectively unforeseeable by the settlor could require a fiduciary to override plan terms," 2011 WL 4950368, at *8, cannot be squared with ERISA's mandate that the fiduciary's general obligation to follow plan documents always gives way to the overriding statutory duty to act prudently and loyally in managing the plan and its assets. See Herman v. NationsBank, 126 F.3d 1354, 1368-69 & n.15 (11th Cir. 1997) (rejecting an argument that an "ERISA trustee must follow a plan provision unless it is facially invalid, or unless following the provision would be an abuse of the trustee's discretion," and holding instead that the trustee must "disregard the provision" if it "leads to an imprudent result"). Nor is it consistent with the objective nature of prudence, see Katsaros, 744 F.2d at 279, which is not measured by the subjective expectations of the plan sponsor.

Likewise, the special status of employer securities under ERISA provides no support for the panel's dilution of the prudence standard. It is certainly true that Congress has created explicit incentives to encourage plan ownership of employer stock in the form of favorable tax treatment, a pass from diversification, and an exemption to the prohibited transactions rules that would otherwise forbid the plan's purchase of stock from the employer. See Moench, 62 F.3d at 568.

However, Congress granted preferential tax treatment to all pension plans, and this tax-favored status is one of the reasons that it is particularly important to ensure that ERISA's fiduciary obligations are enforced. See H.R. Rep. No. 93-1280, at 45 (1974), 1974 U.S.C.C.A.N. 5038, 5083 (noting that, in exchange for tax preferences, "the safeguards … that a prudent investor would adhere to must be present"); S. Rep. No. 93-383, at 86, 93 (1974), 1974 U.S.C.C.A.N. 4889, 4978, 4984 (noting that IRS's generally applicable prudence rules continue to apply to employer stock post-ERISA); 119 Cong. Rec. 17651 (daily ed. May 31, 1973). Certainly, the taxpayer is ill-served by a legal standard that permits fiduciaries to waste tax-deductible contributions on stock that is worth significantly less than the plan assets expended on the stock. Preferential tax treatment is one reason that employers will continue to sponsor plans that invest in stock, not a rationale for lesser protections. See 2011 WL 4950368, at *20-*21 (Straub, J., dissenting).

Moreover, both the prohibited transaction exemption and the pass from diversification, as exemptions from "certain per se violations on investments in employer securities," Eaves v. Penn, 587 F.2d 453, 459 (10th Cir. 1978), should generally be read narrowly, as Judge Straub points out in his dissent. 2011 WL 4950368, at *20 (citing Fink v. Nat'l Sav. & Trust Co., 772 F.2d 951, 955-56 (D.C. Cir. 1985) ("fiduciaries must be subject to the closest scrutiny under the prudent person rule, in spite of the strong policy preference in favor of investment in

employer stock") (internal quotations omitted); Eaves, 587 F.2d at 460 ("ESOP fiduciaries are subject to the same fiduciary standards as any other fiduciary except to the extent that the standards require diversification of investments.")). That Congress intended such a narrow construction is especially evident here because in the very same provision in which Congress permitted undiversified investments in employer stock, it expressly declined to otherwise abrogate the fiduciary's duty of prudence. 29 U.S.C. § 1104(a)(2).

Thus, ERISA provides no support for the panel's adoption of a deferential standard of review that provides that, regardless of what a prudent fiduciary in like circumstances would do, a plan fiduciary has no liability if it continued to buy stock at an inflated price, failed to investigate the prudence of stock investments, and disclosed nothing at all to participants about apparent dangers so long as the company was not in a sufficiently "dire" situation.[3] The panel's adoption of this standard as a "substantial shield" for fiduciaries, 2011 WL 4950368, at *8 (citing Kirschbaum, 526 F.3d at 256), represents a wholly unwarranted creation of federal common law. See City of Milwaukee v. Illinois and Michigan, 451 U.S. 304, 312

[3] Whether or not circumstances are dire, prudence always requires fiduciaries to investigate and monitor the appropriateness of any plan investments, as this Court has recognized. See Katsaros, 744 F.2d at 279; cf. Chao v. Merino, 452 F.3d 174, 182 (2d Cir. 2006) ("if a fiduciary was aware of a risk to the fund, he may be held liable for failing to investigate fully the means of protecting the fund from that risk"). Were it otherwise, it is not clear how fiduciaries would even know when circumstances are sufficiently "dire" to require them to take protective action.

(1981) ("Federal courts, unlike state courts, are not general common-law courts and do not possess a general power to develop and apply their own rules of decision"); First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 948 (1995) ("It is undesirable to make the law more complicated by proliferating special review standards without good reasons."). The creation of an alternative, common law standard for fiduciary conduct untethered to the statutory text is particularly unwarranted here because ERISA expressly adopts the familiar trust-law standard of prudence. See Mertens v. Hewitt Assocs., 508 U.S, 248, 259 (1993) ("[t]he authority of courts to develop a 'federal common law' under ERISA . . . is not the authority to revise the text of the statute"); Wilkins v. Mason Tenders Dist. Council Pension Fund, 445 F.3d 572, 581 (2d Cir. 2006) (finding no basis for deferring to fiduciary decisions with respect to statutory compliance). Moreover, as the dissent correctly points out, the largely "undefined" new standard adds not a wit of certainty to the equation, while promoting "arbitrary line-drawing" that protects "careless decisions to invest in employer securities so long as the employer's 'situation' is just shy of 'dire.'" 2011 WL 4950368, at *15.

Even if a measure of deference were appropriate in some circumstances, it is wholly inappropriate to create a standard that excuses plan fiduciaries from overpaying for stock that they knew, or should have known, was artificially inflated because of misrepresentations or inadequate public disclosures of the

companies' exposure to subprime lending, as alleged here. 2011 WL 4950368, at *4, *10; Citigroup Complaint, A-100, 105, 111-12, ¶¶ 197, 219, 238-39; Gearren Complaint, A-1569, 1572-78, ¶¶ 52, 54, 66-70. In this context, presuming that the fiduciaries acted prudently is unwarranted, and whether the company is in a "dire situation" is irrelevant. This follows from the well-established rule that a fiduciary breaches his duties by paying too much for an asset for the plan. See, e.g., Martin v. Feilen, 965 F.2d 660, 671 (8th Cir. 1992). Knowingly overpaying for an asset is never prudent or in the best interest of plan participants and beneficiaries, and this Court has recognized as much. See Donovan v. Bierwirth (II), 754 F.2d 1049, 1054-55 (2d Cir. 1985) (where fiduciaries "caused the plaintiffs to sell too cheaply or to buy too dearly," they are "liable for the difference between what the plaintiffs paid … and what the stock was in fact worth"). See also LaLonde v. Textron, Inc., 369 F.3d 1, 6-7 (1st Cir. 2004) (misrepresentations that caused artificial inflation of stock price could establish fiduciary breach); Restatement (Third) of Trusts § 205 cmt. e, illus. 9 ("if a trustee is authorized to purchase property for the trust, but in breach of trust he pays more than he should pay, he is chargeable with the amount he paid in excess of its value"); Horn v. McQueen, 215 F. Supp. 2d 867, 875 (W.D. Ky. 2002) (presumption of prudence only applies to claims for failure to divest existing holdings, no deference applicable in overpayment claims). [4] Cf. U.S.

[4] Even where prudence dictates that the fiduciary take some course of action to

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"). But that is exactly what is allowed under the panel's decision: so long as the company is not in a "dire situation," even fiduciaries who know that that the market is being misled about the value of the stock need not consider taking action, but may allow the plans they serve to continue buying stock at inflated prices.

II. THE PANEL'S HOLDING THAT THE FIDUCIARIES HAVE NO DISCLOSURE OBLIGATIONS IN THIS CASE CONFLICTS WITH UNIFORM CASE LAW FROM OTHER CIRCUITS

In addition to foreclosing the need for fiduciaries to take any action with regard to company stock until the company's situation is sufficiently dire, the panel held that fiduciaries need never disclose information to plan participants and the market about the stock investment as a means of protecting plan participants, apparently no matter how "dire" the situation. 2011 WL 4950368, at *11. This holding conflicts with the universally recognized duty of ERISA fiduciaries, like

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protect plan participants in light of serious and undisclosed problems, however, it does not necessarily require the divestiture of the plan's holdings in employer securities if such a course of action would not protect the plan's participants or another action would better protect them. See Diduck v. Kaszycki & Sons Contractors, Inc., 874 F.2d 912, 917 (2d Cir. 1979).

their trust-law counterparts, to disclose information that participants and beneficiaries need to know. Under 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 (1959); Globe Woolen Co. v. Utica Gas & Elec. Co., 224 N.Y. 483, 489 (N.Y. 1918) (a trustee may not remain silent "if there is improvidence or oppression, either apparent on the surface, or lurking beneath the surface, but visible to his practiced eye"). Thus, every other Circuit to have considered the issue has concluded broadly that ERISA's duties of prudence and loyalty incorporate the trust-law duty to disclose information to plan participants where a fiduciary "knows that silence might be harmful." Bixler v. Cent. Penn. Teamsters Health & Welfare Fund, 12 F.3d 1292, 1300 (3d Cir. 1993).[5]

Contrary to the panel's conclusion, these cases do not all "relate to administrative, not investment matters" such as eligibility or calculation of benefits, e.g., Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 598 (8th Cir. 2009) (undisclosed fees and other information about stock investments), and the

[5] Accord Watson v. Deaconess Waltham Hosp., 298 F.3d 102, 115 (1st Cir. 2002); Griggs v. E.I. DuPont de Nemours & Co., 237 F.3d 371, 381 (4th Cir. 2001); McDonald v. Provident Indem. Life Ins. Co., 60 F.3d 234, 237 (5th Cir. 1995); Krohn v. Huron Mem. Hosp., 173 F.3d 542, 548 (6th Cir. 1999); Anweiler v. Am. Elec. Power Serv. Corp., 3 F.3d 986, 991 (7th Cir. 1993); Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 598 (8th Cir. 2009); Barker v. Am. Mobil Power Corp., 64 F.3d 1397, 1403 (9th Cir. 1995); Eddy v. Colonial Life Ins. Co. of Am., 919 F.2d 747, 750-51 (D.C. Cir. 1990).

reasoning of these cases fully supports a disclosure duty here, where benefits are not guaranteed and the value of each participant's pension benefits ultimately is based on the performance of the investments. See LaRue v. DeWolff, Boberg & Assocs., Inc., 552 U.S. 248, 250 n.1, 255-56 (2008). Particularly where the fiduciaries take no other action to protect plan participants, such as putting a stop to the purchase of stock at inflated prices, public disclosure may be the simplest and most effective way of ensuring that the market price reflects the true value of the companies' stock and that plan participants can protect their interests. The plaintiffs are not, as the panel suggests, asking for investment advice from the fiduciaries or requesting that the fiduciaries give their opinions about the "expected performance" of the company stock. If, however, as the plaintiffs plausibly allege, the fiduciaries knew that plan participants' retirement accounts were at real risk because of significant financial and reporting improprieties, the fiduciaries had to do more than give the participants' warnings about the general risks of non-diversification. Because the Court's opinions instead say that the fiduciaries were free to do nothing at all, they should be reversed.

CONCLUSION

For the foregoing reasons, the Secretary respectfully requests that the Court grant the petitions for panel or en banc rehearing and reverse the decision of the district court dismissing these suits.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionately spaced typeface using Microsoft Office Word 2003 in 14-point Times New Roman font and is 15 pages long in compliance with Rules 35.1 and 40.

Dated: December 6, 2011

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CERTIFICATE OF SERVICE

I hereby certify that on the 6th day of December 2011, true and correct copies of the foregoing - Brief of Amicus Curiae, Secretary of Labor, in Support of Appellants' Petition for Panel or En Banc Rehearing -- were served upon all counsel of record by UPS, prepaid, for next day delivery, and by electronically via email to the following at the addresses set forth below:

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