No. 11-2660

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

LINDA WHITE, *et al.*,
Plaintiffs-Appellants,

v.

MARSHALL & ILSLEY CORPORATION, *et al.*,
Defendants-Appellees.

On Appeal from the United States District Court
Eastern District of Wisconsin

BRIEF OF THE SECRETARY OF LABOR, HILDA L. SOLIS, AS AMICUS CURIAE IN SUPPORT OF PLAINTIFFS-APPELLANTS AND REQUESTING AFFIRMANCE IN PART AND REVERSAL IN PART

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STATEMENT OF THE ISSUES

This appeal stems from a class action lawsuit that alleges that the fiduciaries to a defined contribution 401(k) plan 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 stock of the sponsoring company during a period when this stock was such a risky investment that a prudent man would not have invested plan assets in the stock. The questions that the Secretary addresses are:

1. Whether the district court properly rejected defendants' argument that plan language mandating plan investment in employer stock – no matter how "dire" the financial circumstances – relieved them, as plan fiduciaries, of their statutory duties with regard to the selection and retention of Marshall & Ilsley stock as an investment for the plan.

2. Whether the district court erred in concluding that the fiduciaries were entitled to a presumption that they acted prudently in retaining the employer stock as a plan investment and that they were entitled to dismissal on this basis because the plan participants failed to plead facts that plausibly suggested that Marshall & Ilsley's viability was threatened and that the company's stock was in danger of becoming essentially worthless.

STATEMENT OF INTEREST, IDENTITY AND AUTHORITY TO FILE

ERISA is a comprehensive statute designed to promote the interests of employees and their beneficiaries in employee benefit plans, Shaw v. Delta Air Lines, Inc., 463 U.S. 85, 90 (1983), primarily by imposing a number of stringent duties on fiduciaries, including a duty of loyalty, a duty of care grounded in

traditional trust law's prudent man standard, and a duty to follow plan documents only to the extent that they are consistent with ERISA. 29 U.S.C. §1104(a)(1)(A), (B) and (D). 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), and that plan participants and beneficiaries are able to enforce these duties in federal court.

For this reason, the Secretary has a strong interest in urging the Seventh Circuit to join its sister circuits in rejecting an interpretation of ERISA that allows plan sponsors to immunize plan fiduciaries from liability for investing in employer stock even if the investment is imprudent, so long as the plan documents mandate investment in employer stock. The Secretary also has a strong interest in urging the Seventh Circuit to decline to affirm the district court's dismissal of this case based on that court's erroneous application of an unjustifiably onerous version of the presumption of prudence first applied to employer stock investments in Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995). The Secretary files this brief pursuant to her authority Federal Rule of Appellate Procedure 29(a).

STATEMENT OF FACTS

Linda White and Charlene Roundtree are former employees of Marshall & Ilsley Corporation (M&I), and participants in the Marshall and Ilsley Retirement Program ("Plan"), an ERISA-covered employee benefit plan. Compl. ¶¶ 1, 33. They purport to represent a class of all current and former Plan participants whose accounts, like theirs, held shares of M&I common stock any time from November 10, 2006 to and including April 21, 2010 ("the Class Period"). Id. ¶ 1.

M&I is a Wisconsin-based bank holding company. Compl. ¶ 11. Throughout the Class Period, M&I was the sponsor as well as the named administrator of the Plan. Id. at ¶ 11. Under the Plan, the fiduciaries selected a number of investment options in which individual participants could choose to allocate their funds. Id. ¶¶ 12, 36, 37. Participants in the M&I Plan could contribute up to 50% of their salaries to their individual investment accounts. M&I agreed to make a matching contribution of 50% of the participants' contributions, up to a maximum of 6% of the participant's compensation, following one year of service. Compl. ¶ 35.

The governing Plan documents mandated that the Plan include an M&I stock fund among the investment alternatives and that the fund maintain its investments in company stock "whether or not it is a prudent investment." Compl. ¶46 (emphasis added). Throughout the Class Period, defendants maintained M&I stock

in the Plan menu of investment alternatives. Id. at ¶¶ 1-5. M&I's principal assets are the stock of its bank and nonbank subsidiaries, which, as of February 15, 2009, consisted of five bank and trust subsidiaries and a number of companies engaged in business that are closely-related or incidental to the business of banking. Id. at ¶11.

Plaintiffs allege that the company had originally been risk-averse, but that in 2005 and 2006 it acquired subsidiary banks in Florida and Arizona that were making risky mortgage loans. Id. at ¶¶ 76, 78, 95, 103, 139, 143. By the following year, M&I's profit margin declined significantly because of non-performing loans. Id. at ¶ 81. Moreover, plaintiffs allege that, during that time, the company failed to report losses due to the underperforming loans. Compl. ¶¶ 79, 80.

On July 26, 2007, M&I stock began a steep decline, triggered by concerns with its non-performing loans, which was followed by five more consecutive quarterly losses. Compl. ¶ 135. Indeed, the company's non-performing loans eventually exceeded 5%, a level which, according to a Bloomberg News report cited by the plaintiffs, "can wipe out a bank's equity and threaten its survival." Id. ¶ 121. This led to M&I borrowing $1.7 billion in capital from the federal government through the Troubled Asset Relief Program and an additional $775 million from private lenders. Id. at ¶¶ 105, 107, 126, 166. Plaintiffs alleged that

these problems "created dire financial circumstances" that made the Plan's investments in the M&I stock imprudent. Id. ¶ 139.

As a result of the company's poor loan quality, extensive write-downs and amounts that the company had to set aside to pay for the non-performing loans, and continuous downgrades during the class period, the company's stock, which had been trading at $46.92 on November 10, 2006, swiftly and steadily declined to reach as low as $5.31 by the end of the Class Period, a decrease of $41.61, or almost 89%. Id. at ¶ 138. During this entire time, Plan fiduciaries maintained the stock fund as an investment alternative in the Plan. Id. at ¶ 2.

PROCEDURAL POSTURE

On April 13, 2010, plaintiffs filed suit in the U.S. District Court for the Eastern District of Wisconsin against M&I and several named corporate officers who were fiduciaries to the Plan. Plaintiffs allege that during the Class Period, defendants materially misrepresented the company's financial condition, and, with knowledge that M&I was in catastrophic decline and that the value of M&I common stock was artificially inflated, defendants continued to offer M&I stock as an investment option on the investment menu. Compl. at ¶139. The complaint states two causes of action under ERISA: failure to prudently and loyally manage the Plan's assets, id. at ¶¶146-155; and failure to adequately monitor other fiduciaries and provide them with accurate information, id. at ¶¶ 156-165.

Defendants moved to dismiss the complaint in its entirety pursuant to Federal Rule of Civil Procedure 12(b)(6), and the district court granted the motion. As an initial matter, the court recognized that "[a]s fiduciaries, the defendants were required to take steps to protect the Plan from investments that had become imprudent." White v. Marshall & Ilslely Corp., No. 10-cv-00311, 2011 WL 2471736, *3 (E.D. Wisc. 2011) (citing Armstrong v. LaSalle Bank Nat'l Ass'n, 446 F.3d 728, 734 (7th Cir. 2006)). Moreover, the court reasoned that "even when a plan requires an employer to offer its own stock as an investment option, and despite the exemption from diversification [in ERISA] for such plans, there are still situations in which ERISA's duty of prudence could require diversification of an ESOP's holdings." White, 2011 WL 2471736, at * 3 (citing Pugh v. Tribune Co, 521 F.3d 686, 701 (7th Cir. 2008); Summers v. State St. Bank. & Trust Co., 453 F.3d 404, 410 (7th Cir. 2006); Steinman v. Hicks, 352 F.3d 1101 (7th Cir. 2003)).

On this basis, the court rejected defendants' argument that the plan provisions mandating the investment in M&I stock effectively overrode the fiduciary duty of prudence, even if the provisions reflected the plan sponsor's intent that the fiduciaries continue to invest in the company stock "when faced with dire financial circumstances or the threatened viability of M&I." 2011 WL 2471736, at * 4. The court declined to adopt this "hard-wiring" theory, noting that it could

"serve as a loophole through which fiduciaries could escape the duty of prudence altogether." Id. at *5.

Nevertheless, citing the Seventh Circuit's decisions in Howell v. Motorola, Inc., 633 F.3d 552, 568 (7th Cir. 2011) and in Summers, the district court held that, in considering the claim, it must apply the Moench presumption of prudence because the Plan required the investment in company stock. White, 2011 WL 2471736, at *3. The court determined that the plaintiffs did not "overcome the presumption in this case," because their complaint did not "demonstrate either an excessive risk of impending collapse or some other equivalent dire circumstances." Id. at *4, *6-*7. Instead, the court found that, "while the company's risky lending practices depressed both M&I's stock prices and its ratings," id. at *7, the facts alleged by the plaintiffs did "not plausibly suggest that M&I's 'viability as a going concern' was ever threatened or that the company's 'stock was in danger of becoming essentially worthless.'" Id. at *6 (quoting Kirschbaum v. Reliant Energy, Inc., 526 F.3d 243, 255 (5th Cir. 2008)).

SUMMARY OF THE ARGUMENT

Relying on Seventh Circuit precedent, the district court correctly held that defendants, as plan fiduciaries, were subject to ERISA's fiduciary duties of prudence and loyalty when managing the Plan's investment in M&I stock. The court thus properly rejected defendants' argument that they should be relieved of any fiduciary

obligations with regard to the M&I stock simply because the Plan terms mandated this investment even in dire circumstances.

However, the district court erred by granting defendants' motion to dismiss based upon a presumption of prudence neither contemplated, nor supported by, ERISA. The statute unambiguously requires fiduciaries to adhere to their duties of prudence and loyalty, even, and perhaps especially, in the context of employer stock, where they are otherwise relieved of their duty to diversify. No other standard of conduct is warranted and no forgiving standard of review is consistent with these strict statutory duties. Assuming this is still an open issue in the Seventh Circuit, this Court should decline to adopt the Moench presumption of prudence in any form.

In the alternative, this Court should reject cases that presume that an investment in employer stock is reasonable so long as the sponsoring company is not in a dire situation or on the verge of collapse. Nor should this Court look to the intent of the plan sponsor in determining whether the plaintiffs have rebutted the presumption that investment in the stock of the sponsor was reasonable. Instead, this Court should adopt the modest presumption recently articulated by the Sixth Circuit, which requires a plaintiff to prove that a prudent fiduciary would have made a different investment decision under the circumstances. This standard is based on ERISA's statutory fiduciary requirements, and allows courts sufficient flexibility to

address the unique circumstances that might give rise to a breach of duty claim. Importantly, however, it should not be decided on a motion to dismiss on the pleadings before any factual development of the issues has occurred. Instead, if this Court adopts a presumption of prudence, it should join the Sixth Circuit in holding that the presumption does not create an additional pleading requirement, but may only be applied, if at all, on summary judgment or after trial.

Finally, if, as plaintiffs maintain, defendants failed to exercise any discretionary judgment with regard to the M&I stock fund, perhaps because they believed they were foreclosed from even considering eliminating the stock fund, they are not entitled to any presumption that they acted prudently. This possibility is another reason that the district court's dismissal of the case on the pleadings was improper.

DISCUSSION

I. The District Court Properly Held That Plan Language Mandating Continued Investment In M&I Stock Did Not Excuse Defendants From Their Obligation To Consider The Prudence Of Continued Investment In M&I Stock

ERISA safeguards the "financial soundness" of employee benefit plans "by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing appropriate remedies, sanctions, and ready access to the Federal courts." 29 U.S.C. § 1001(a), (b). To this end, section 404(a) of ERISA, titled "Prudent man standard of care," places a set of obligations

on fiduciaries that embody the bedrock trust law duties of prudence and loyalty. Id. § 1104(a). First, plan fiduciaries must act "for the exclusive purpose: of (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan." Id. § 1104(a)(1)(A). Second, fiduciaries must 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." Id. § 1104(a)(1)(B). Third, fiduciaries must "diversify[] the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." Id. § 1104(a)(1)(C). Finally, 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]." Id. § 1104(a)(1)(D)(emphasis added). Similarly, section 410 of ERISA, 29 U.S.C. § 1110, invalidates any provision in any "agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty" provided under ERISA's fiduciary provisions. Thus, ERISA does not permit plan sponsors to opt out of ERISA's fiduciary framework and protections.

ERISA includes one limited exception to these requirements: with regard to eligible individual account plans (EIAPs), "the diversification requirement of

paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of" employer stock. Id. § 1104(a)(2). The M&I Plan appears to fall within the statutory definition of an EIAP because it is an individual account 401(k) savings plan that "explicitly provides for acquisition and holding of" employer stock. Id. § 1107(d)(3) (defining EIAP). Defendants are therefore exempt from the per se obligation to limit the percentage of Plan holdings invested in M&I stock, i.e., the duty to diversify.

As is plain from the text of ERISA, however, defendants are not otherwise exempt from fulfilling their responsibilities as fiduciaries, including the obligation to act prudently with respect to the plan's investments in stock of the sponsoring company. See Central States SE & SW Areas Pension Fund v. Central Transp., Inc., 472 U.S. 559, 568 (1985) ("trust documents cannot excuse trustees from their duties under ERISA"). The statutory exemption's caveat that EIAP fiduciaries are exempt from the prudence requirement "only to the extent that it requires diversification" can have no other meaning. 29 U.S.C. § 1104(a)(2) (emphasis added). Reading it otherwise would improperly expand the statutory exemption. See John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 97 (1993) (noting in discussing a different exemption within ERISA that courts are "inclined, generally, to tight reading of exemptions from comprehensive schemes

of this kind," and that "when a general policy is qualified by an exception, the Court 'usually read[s] the exception narrowly in order to preserve the primary operation of the [policy]'" (citation omitted)).

Thus, the diversification exemption relieves a fiduciary from the per se requirement that they diversify plan assets invested in company stock, but does not otherwise relieve him of the obligation to "discharge his duties respecting the plan solely in the interests of plan participants and beneficiaries and in a prudent fashion," Peabody v. Davis, 636 F.3d 368, 374 (7th Cir. 2011), including by divesting company stock, where prudence dictates that result. See, e.g., Moench, 62 F.3d at 669-70; Kuper v. Iovenko, 66 F.3d 1447, 1457 (6th Cir. 1995) ("the purpose of ESOPs cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit plans"); Pugh, 521 F.3d at 701; Steinman, 352 F.3d at 1106; Martin v. Feilen, 965 F.2d 660, 665 (8th Cir. 1992); Eaves v. Penn, 587 F.2d 453, 459 (10th Cir. 1978); Fink v. Nat'l Sav. & Trust Co., 772 F.2d 951, 955-6 (D.C. Cir. 1985) (fiduciaries for eligible individual account plan comprised solely of employer stock still subject to duty of prudence and loyalty) .

Here, plaintiffs are not arguing that the fiduciaries breached their obligation to diversify by essentially investing too heavily in otherwise prudent M&I stock. Instead, they are arguing that any continued investment in M&I stock was imprudent during the class period given the excessively risky business lending

practices of subsidiary banks that led to a large number of defaults and non-performing assets. This is particularly true because the price was inflated by misleading and inaccurate disclosures. As a result, every time the plan expended contributions or other assets on the stock, it received less in exchange than it should have for what it expended. The purchase of even a single share in such circumstances is imprudent. Accordingly, ERISA's limited pass from diversification is inapplicable to this case. See In Re Estate of James, 681 N.E. 2d 332, 336-38 (N.Y. 1997) (differentiating between the "hazard" of concentration that diversification protects and other risks of loss that prudence safeguards); First Ala. Bank, N.A. v. Spragins, 475 So. 2d 512, 515-16 (Ala. 1985) (recognizing the continued obligation to prudently manage investments when trust documents exempt fiduciaries from a duty to diversify).

Moreover, all circuits that have addressed the issue have recognized that, in view of ERISA section 404(a)(1)(D), which prohibits ERISA fiduciaries from following plan documents that are inconsistent with ERISA, plan language mandating investment in company stock does not immunize the fiduciaries from any duty with respect to that stock. Lanfear v. Home Depot, --- F.3d ---, 2012 WL 1580614, *11 (11th Cir. 2012) (fiduciaries are required to disregard plan documents to the extent that they were inconsistent with ERISA); In re Citigroup ERISA Litig., 662 F.3d 128, 139 (2d Cir. 2011) ("Especially in light of ERISA's

requirement that fiduciaries follow plan terms only to the extent that they are consistent with ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D), we decline to hold that defendants' decision to continue to offer the Stock Fund is beyond our power to review."); Kuper, 66 F.3d at 1457 ("the purpose of ESOPs cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit plans"); In re Syncor ERISA Litig., 516 F.3d 1095, 1102-03 (9th Cir. 2008); Eaves, 587 F.2d at 459; Fink, 772 F.2d at 955-56. Thus, fiduciaries are only permitted to give affect to ESOP plan documents to the extent that they are consistent with ERISA, and can be liable for following plan directives that require them to commit a fiduciary breach. Indeed, ERISA section 410(a), 29 U.S.C. § 1110(a), expressly makes void any provision purporting to relieve the fiduciaries of their ERISA responsibilities.

The Seventh Circuit has also rejected the argument that ESOP trustees are exempted "from liability for failing to dispose of the stock of the employer." See Harzewski v. Guidant Corp., 489 F.3d 799, 807 (7th Cir. 2007). Instead, the Harzewski court allowed a claim to proceed, based upon allegations that corporate insiders "knew that the price of [company] stock was overvalued but took no measures to protect the participants in the employee benefit plan." Harzewski, 489 F.3d at 807. This is especially relevant here, as Plaintiffs allege that despite their knowledge that the stock was an imprudent investment due to the company's risky

and largely hidden mortgage practices, the fiduciaries continued to allow the Plan to remain invested in the stock and, in fact, to continue to purchase additional shares.

For these reasons, the district court correctly rejected the argument that defendants were excused of any duty to consider limiting or divesting the Plan's investments in M&I stock by Plan language that mandated investment in such stock "no matter how dire the circumstances." As the lower court recognized, acceptance of such an argument could "serve as a loophole through which fiduciaries could escape the duty of prudence altogether," merely by writing out ERISA's requirements, White, 2012 WL 2471736, at *5, a result that is expressly forbidden by sections 404(a)(1)(D) and 410(a).

II. The District Court Erroneously Applied a Presumption Of Prudence To Dismiss the Case On The Pleadings Based On Its Conclusion That Plaintiffs Failed to Plead That M&I's Viability Was Threatened And That Its Stock Was In Danger Of Becoming Essentially Worthless

a. Plaintiffs' allegations state a claim for fiduciary breach

Plaintiffs have plausibly alleged that M&I was a traditionally risk-averse bank, but that it strayed from these principles in 2005 and 2006 by acquiring risky mortgage loans. Compl. ¶¶ 78, 95, 103, 139, 143. Subsequent to these acquisitions, plaintiffs allege that M&I's profit margin began to decline because it was forced to set aside large sums of money to satisfy its loan-loss provisions in the event of non-performing loans. Id. at ¶ 81. Based upon multiple quarters of

steep decline in stock prices and worries about overexposure to risky loans, plaintiffs allege that M&I was repeatedly downgraded by ratings agencies. Id. at ¶¶ 85,89, 91, 95, 97, 100. Plaintiffs' complaint further alleges that, during the class period, M&I failed to report losses due to the underperforming loans – and that this concealed information caused artificial inflation of the stock price. Id. at ¶¶ 79-80. Finally, the complaint alleges that poor loan quality, extensive write-downs, and the amounts set aside necessary to pay for the non-performing loans, and continuous downgrades during the class period caused a nearly 89% decline in M&I's stock price during the class period. Compl. ¶ 138. Considering the totality of the allegations, dismissal was inappropriate because plaintiffs plead, with sufficient specificity, that defendants breached their fiduciary duties by allowing the Plan to continue to invest in M&I stock during this period.

b. The Seventh Circuit should decline to adopt a presumption of prudence

Despite its recognition that ERISA's stringent trust-based duties applied to the fiduciaries' management of the employer stock investments, the district court improperly relied upon a judicially-created "presumption of prudence" standard first articulated by the Third Circuit in Moench to conclude that plaintiffs had failed to state a claim. White, 2011 WL 2471736, *5-6. In Moench, a plan participant sued an employee stock ownership plan (ESOP) committee for breach of fiduciary duty based on the plan's continued investment in employer stock

during a period of significant employer financial decline. 62 F.3d at 558-59. The Moench court held, based upon Congress' dual purposes of providing employee ownership and employer financing through an ESOP, that ESOP fiduciaries who maintain en ESOP investment in employer stock are entitled to a rebuttable presumption that they acted consistently with ERISA. Id. at 571. The court then held that the factors Moench alleged (precipitous drop in stock price, committee members' knowledge of the impending collapse, and their conflicted loyalties as corporate insiders and fiduciaries), if proven, could overcome the presumption. Id. at 572. On that basis, the court reversed summary judgment for defendants. Id.

A number of other circuits have now adopted some version of the Moench presumption, although they vary significantly as to what the presumption does, how it is rebutted and at what stage it applies. Compare Lanfear, 2012 WL 1580614, at *8, *10-*11 (Moench creates a "forgiving" standard of review and an additional pleading requirement under which plaintiffs must plausibly allege that the "fiduciary could not have believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations," although they need not allege that the company was on the "verge of collapse"); Citigroup, 662 F. 3d at 138, 140 (Moench is applicable on the pleadings and can only be rebutted under a "dire financial situation" test); Quan v. Computer Scis. Corp. , 623 F.3d 870, 881 (9th Cir. 2010) (applying "precipitous decline" or "brink of collapse"

rebuttal standard on summary judgment); Kirschbaum v. Reliant Energy, 526 F.3d 243, 254-56 (5th Cir. 2008) (applying "viability as a going concern/worthless stock" standard of rebuttal on summary judgment); Edgar v. Avaya, 503 F.3d 340, 348-49 (3d Cir. 2007) (rejecting "brink of bankruptcy" test but affirming dismissal on the pleadings based on Moench where plaintiffs did not plead possible fraud or corporate wrongdoing), with Pfeil v. State Street Bank and Trust Company, 671 F.3d 585, 595 (6th Cir. 2012) (adopting an abuse of discretion standard of review that may be rebutted by showing that a prudent fiduciary would have made a different investment); DeFelice v. U.S. Airways, Inc., 497 F.3d 410, 422-23 (4th Cir. 2007) (stating in dicta that ordinary prudence and not a more lenient standard of fiduciary conduct applies in the context of an employer stock fund). This disuniformity in the various formulations and applications of Moench is not surprising given the lack of any textual foundation for the presumption.

As we have noted, the Seventh Circuit has repeatedly recognized that ERISA's diversification exemption that is applicable to some employer stock funds does not otherwise excuse a fiduciary from his obligations to "discharge his duties respecting the plan solely in the interests of plan participants and beneficiaries and in a prudent fashion," Peabody, 636 F.3d at 374. Indeed, the Seventh Circuit has noted that plans that are exempt from ERISA's diversification duty "demand[] an even more watchful eye, diversification not being in the picture

to buffer the risk to the beneficiaries should the company encounter adversity." See Armstrong, 446 F.3d at 732.

At the same time, this Court has also cited Moench and its progeny with seeming approval on several occasions. See Summers, 453 F.3d at 410 (discussing Moench presumption but noting that plaintiff "never sought to explore these issues"); Pugh, 521 F.3d at 701 (after citing Moench and noting that the amount that the circulation figures for the paper were overstated was "less than 2 percent of one year's revenue for Tribune," the Court concluded that "if it were necessary to resolve the issue, we would likely find that the complaint fails to adequately allege that the defendants acted imprudently by not discontinuing the company stock fund"); Howell, 633 F.3d at 568 (citing Moench, the Court affirms summary judgment to the defendants, reasoning that "[n]othing should have tipped the Plan's fiduciaries off to the (dubious) proposition that Motorola stock had become so risky or worthless that the Motorola Stock Fund itself had to be withdrawn from the Plan immediately"). However, most recently, this Court has said this about the Moench presumption:

> In any event, while the express duty to diversify is inapplicable to EIAPs investing in employer securities, the full ERISA duty of prudence nevertheless applies. . . . Some courts, beginning with the Third Circuit in Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995), have reconciled the residual duty of prudence with the absence of an express diversification duty by providing that for an EIAP or ESOP, there is a presumption that investing in employer stock is prudent. See Quan v. Computer Scis. Corp., 623 F.3d 870, 881 (9th Cir. 2010) (adopting Moench in the 9th Cir.); see also

> Summers, 453 F.3d at 410 (citing Moench with approval, although not expressly adopting it).

Peabody, 636 F.3d at 374. The court then commented, in a footnote that it was "unclear whether this 'Moench' presumption should apply to all EIAPs, or only to ESOPs," id. at 374 n.6, but ultimately determined that it "need not grapple with the extent of Moench's force as to EIAPs in this circuit," because it concluded that the fiduciaries had breached their duty of prudence even if the Moench presumption applied. Id. at 375.

Based on this most recent discussion of the issue in Peabody, it appears that the applicability of a presumption of prudence to an employer stock option in a 401(k) plan is still an open issue in the Seventh Circuit. If this Court agrees, we urge this Court to reject the Moench presumption as unwarranted. Because the statute unambiguously makes all fiduciary activity subject to the prudent man standard of conduct, qualified only by a limited exception to the diversification requirement for certain plans that authorize investment in employer stock, there is simply no justification to formulate and substitute a more forgiving standard, untethered to the statute, that would allow fiduciaries to continue to invest plan assets in company stock even where prudent fiduciaries acting in like circumstances would not do so. See DeFelice, 497 F.3d at 422-23 ("ERISA itself sets forth the only test of a fiduciary's duties: the requirement that fiduciaries 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 an enterprise of a like character and with like aims.'") (quoting 29 U.S.C. § 1104(a)(1)(B)) (emphasis in original). The proper test asks simply whether a prudent fiduciary would have continued to purchase and maintain the employer stock investments for the plan under the circumstances.

The district court in this case held that, regardless of what a prudent fiduciary in like circumstances would do, a plan fiduciary has no liability for continuing to purchase employer stock at an inflated price and to hold that stock as a Plan investment during a period when M&I's largely undisclosed and "risky lending practices depressed both M&I's stock prices and its ratings," 2011 WL 2471736, at *7, "so long as M&I's 'viability as a going concern'" was not threatened or "the company's 'stock was [not] in danger of becoming essentially worthless.'" Id. at *6 (quoting Kirschbaum v. Reliant Energy, Inc., 526 F.3d 243, 255 (5th Cir. 2008)). Thus, the plan fiduciaries could knowingly pay more for the stock than it was worth, wasting plan assets.

This creation of a standard that immunizes fiduciaries from liability for Plan investments in company stock so long as there was not "an excessive risk of impending collapse or some other equivalent dire circumstances," id. at *4, *6-*7, represents a wholly unwarranted creation of federal common law. See City of Milwaukee v. Illinois and Michigan, 451 U.S. 304, 312 (1981) ("[f]ederal 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," and should do so only when "compelled to consider federal questions which cannot be answered from federal statutes alone"); 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 care. See, e.g., Mertens v. Hewitt Assocs., 508 U.S. 248, 259 (1993) (citation omitted) ("[t]he authority of courts to develop a 'federal common law' under ERISA ... is not the authority to revise the text of the statute"); cf. Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 146 (1985) (ERISA is a "comprehensive and reticulated statute") (citation omitted).

Nor is the plan sponsor's intent to include employer stock in the Plan, as expressed in the plan documents, a justification for holding plan fiduciaries to a more forgiving standard of fiduciary conduct. As we have explained, because the statute clearly provides that fiduciaries must follow plan documents only "insofar as such documents and instruments are consistent with" ERISA, 29 U.S.C. § 1104(a)(1)(D), ERISA bars "deviations" from fiduciary duties based on plan language. S. Rep. No. 93-127 (1974), reprinted in, 1974 U.S.C.C.A.N. at 4866.

Thus, 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 in purpose and nature." H.R. Rep. No. 93-533 (1973), reprinted in, 1974 U.S.C.C.A.N. 4639, 4650.

The settlor's intent to require the investment in employer stock must always give way to the overriding statutory duty to act prudently and loyally in managing the plan and its assets. See Herman v. NationsBank Trust Co., 126 F.3d 1354, 1368-69 & n.15 (11th Cir. 1997) (holding that an ERISA trustee must "disregard" a plan provision if following it "leads to an imprudent result"). Furthermore, measuring a fiduciary's conduct based on the subjective expectations of the plan sponsor is inconsistent with the objective nature of prudence, which is "measured according to the objective 'prudent person' standard developed in the common law of trusts." Katsaros v. Cody, 744 F.2d 270, 279 (2d Cir. 1984).

The Moench presumption is particularly unwarranted insofar as the plaintiffs have plausibly alleged that the fiduciaries knew that the price of the stock was artificially inflated because of misleading securities statements and statements made to plan participants that downplayed the company's mounting losses. Compl. ¶ 139. Knowingly overpaying for an asset is never prudent or in the best interest of

plan participants and beneficiaries and a fiduciary breaches his duties by doing so. See, e.g., Martin v. Feilen, 965 F.2d 660, 671 (8th Cir. 1992); Lalonde v. Textron, Inc., 369 F.3d 1, 6-7 (1st Cir. 2004) (misrepresentations that caused artificial inflation of stock price could establish 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 pays more than he should, he is chargeable with the amount he paid in excess of its value"). At a minimum, such allegations support a claim that the fiduciaries acted imprudently in continuing to allow the Plan to purchase additional shares of M&I stock at an inflated price during this period, regardless of the overall health of the company. See Syncor, 516 F.3d at 1102 ("A prudent man standard based only on a company's alleged financial viability does not take into account the myriad of circumstances that could violate the standard."); In re Schering-Plough Corp. ERISA Litig., 420 F.3d 231, 237-38 (3d Cir. 2005) (suggesting that Moench presumption did not apply in a case involving investment in employer stock alleged to be "unlawfully and artificially inflated" in value).

c. Alternatively, this Court should reject the "viability" standard applied by the district court and should instead adopt the standard applied by the Sixth Circuit in Pfeil and hold, like that court, that the presumption may only be considered on summary judgment and not to support dismissal on the pleadings

Even if this Court adopts a presumption of prudence, it should reject the unjustifiably onerous standard applied by the district court, and the similar

standards that have been adopted by the Second, Fifth and Ninth Circuits. Citigroup, 662 F. 3d at 138, 140; Kirschbaum, 526 F.3d at 254-56; Quan, 623 F.3d 870, 881. Nor, for the reasons discussed above, supra at 17, should this court adopt a deferential standard tied to the plan sponsor's expectations, as the Eleventh Circuit recently did. Lanfear, 2012 WL 1580614, at *8, *10-*11.

Instead, if this Court adopts a presumption of prudence, it should as the Sixth Circuit recently did, adopt a "rebuttal standard . . . [that] requires a plaintiff to prove that 'a prudent fiduciary acting under similar circumstances would have made a different investment decision.'" Pfeil, 671 F.3d at 595 (quoting Kuper v. Iovenko, 66 F.3d at 1447, 1459 (6th Cir. 1995)). Under this standard, the plaintiff must show not only that a prudent fiduciary would have exercised a better process or taken more care in reaching a decision, but that a prudent fiduciary would actually have invested the plan's assets differently. While this standard places some additional emphasis on the fact that the plaintiff bears the burden of proving imprudence, it is grounded in the statutorily-derived prudent man standard, and "retains enough flexibility to address the unique circumstances that might give rise to a breach-of-duty claim." Pfeil, 671 F.3d at 595.

Furthermore, like the Pfeil court, this court should decline to adopt any presumption of prudence at the pleadings stage, before the parties have had any opportunity to conduct discovery. To the extent that the Seventh Circuit has relied

on Moench to support dismissal, it has done so on summary judgment, not on the pleadings. See Howell, 633 F. 3d at 569. Moench itself was decided on a motion for summary judgment and the presumption that it creates may be rebutted based on the evidence. 62 F.3d at 571; see also Kuper, 66 F.3d at 1459. It is thus an "evidentiary standard, and concerns questions of fact," and does not, as the Sixth Circuit recently held, create an "additional pleading requirement." Pfeil , 671 F.3d at 592-593 (citing In re Regions Morgan Keegan ERISA Litig. , 741 F. Supp. 2d 844, 849 (W.D. Tenn. June 30, 2010) (listing numerous district court cases declining to apply Moench on the pleadings)). The Sixth Circuit's ruling is "consistent with the standard of review for motions to dismiss generally," which requires courts "to accept well-pleaded factual allegations of a complaint as true and determine whether those allegations state a plausible claim for relief." 671 F.3d at 593. "[A]pplying the presumption at the pleadings stage, and determining whether it is sufficiently rebutted," would be inconsistent with notice pleading standards under the federal rules. Id.

d. Application of the presumption is unwarranted to the extent that the fiduciaries failed to exercise any discretionary judgment as plaintiffs allege

As this Court has correctly recognized, "a discretionary judgment cannot be upheld when discretion has not been exercised." See Armstrong, 446 F.3d at 732-33. For this reason, the Secretary agrees with plaintiffs that, assuming plan fiduciaries are ever entitled to a presumption of prudence, application of such a

presumption is unwarranted to the extent that the fiduciaries failed to exercise any discretionary judgment. Here, plaintiffs alleged that the fiduciaries "did little, if anything" and "failed to take any meaningful steps to protect the Plans and their Participants" from the losses that the fiduciaries should have known would ensue from the company's snowballing problems. Compl. ¶¶ 4, 151. It is impossible to know at this stage in the proceedings whether the defendants intentionally decided to allow the Plan to continue to invest in M&I stock or instead failed to even consider whether to divest the plan of M&I stock or to remove the stock fund as an option (perhaps because the fiduciaries mistakenly thought that the plan's provisions legally barred them from eliminating the M&I stock fund under any circumstances). But certainly if the latter, application of the Moench presumption is unwarranted under Armstrong, and plaintiffs should at least have the opportunity to conduct discovery on this issue.

CONCLUSION

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

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on May 30, 2012, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Seventh Circuit by using the CM/ECF system.

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Dated: May 30, 2012

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