09-3804-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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

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

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.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE NATIONAL EMPLOYMENT LAWYERS ASSOCIATION, AS AMICUS CURIAE FOR APPELLANTS IN SUPPORT OF REVERSAL

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The following disclosures are made pursuant to Federal Rule of Appellate Procedure 26.1 and Local Second Circuit Rule 26.1: The *amicus*, the National Employment Lawyers Association ("NELA"), is a non-profit organization which is not owned by individual shareholders. NELA does not issue shares to the public.

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THE INTERESTS OF THE *AMICUS CURIAE*[1]

The National Employment Lawyers Association (NELA) is the largest professional membership organization in the country comprised of lawyers who represent workers in labor, employment and civil rights disputes. NELA advances employee rights and serves lawyers who advocate for equality and justice in the American workplace. NELA and its 68 state and local affiliates have a membership of more than 3,000 attorneys who are committed to working on behalf of those who have been illegally treated in the workplace. NELA strives to protect the rights of its members' clients, and regularly supports precedent-setting litigation that affects the rights of workers and retirees.

NELA has filed many amicus briefs to protect the rights of workers and their beneficiaries under the Employee Retirement Income Security Act ("ERISA"). *See, e.g., Cent. Laborers' Pension Fund v. Heinz*, 541 U.S. 739 (2004); *UNUM Life Ins. Co. v. Ward*, 526 U.S. 358 (1999); *Varity Corp. v. Howe*, 516 U.S. 489 (1996); *Firestone Tire & Rubber v. Bruch*, 489 U.S. 101 (1989). NELA members' clients and other employee benefit plan participants depend on ERISA to protect their rights under private employer-sponsored employee benefit plans.

Here, in a sweeping ruling that abrogates ERISA's primary purposes, the court below held that fiduciaries responsible for investment of retirement plan assets are relieved of ERISA's prudent man standard of care if the plan sponsor inserts into the plan document a provision that mandates the investment in or offering of employer securities. This decision violates ERISA's purpose and terms, is contrary to years and years of court decisions, misapplies the common law of trusts, ignores the Department of Labor's ["DOL"] long-held interpretations and guidance, and places at risk billions of dollars of retirement savings of employees and their families.

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[1] The parties have consented to the filing of this amicus brief.

Because this issue is so important, NELA respectfully submits this brief to facilitate the Court's full consideration of the matter. NELA fully supports Plaintiff-appellants' position, and respectfully urges the Court to reverse the District Court.

INTRODUCTION

The question presented by this appeal is whether ERISA allows the person holding plan assets of a pension plan to be relieved of any fiduciary responsibilities simply because the plan sponsor has inserted language in the plan document which mandates investment in employer stock. The court below answered that question in the affirmative, ruling that where pension plan assets are held in trust, the plan sponsor's mandate that assets should be invested in employer stock or that the opportunity to invest in employer stock should be offered eliminates any fiduciary responsibility for assets so invested, including any responsibility for determining that the investment is prudent or in the best interests of plan participants. *See In re Citigroup Erisa Litig.*, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009) ("District Court Ruling").

The practical and policy implications of the District Court Ruling are enormous. Sixty-one percent of households in the United States have assets in defined contribution plan accounts, or were receiving or expecting to receive benefits from defined contribution plans. 2009 *Investment Company Fact Book*, http://www.icifactbook.org/fb_sec7.html (last visited December 21, 2009). Like the 401(k) plans at issue here, thousands of defined contribution plans invest in or offer employer stock. Based on 2006 and 2007 data, defined contributions plans primarily invested in employer securities had an estimated asset value of nearly $1.2 trillion. *See A Brief Overview of Employee Ownership in the U.S.*, http://www.nceo.org/main/article.php/id/52/ (last visited December 21, 2009).

Unlike defined benefit plans, defined contribution plans, including 401(k) plans, are not subject to statutory limitations on investment in employer stock. Accordingly, any protections that ERISA offers to participants in defined contribution plans that invest in employer stock depend on whether management and control of pension assets invested in employer securities subject the holder to ERISA's fiduciary requirements of prudence and loyalty. The District Court Ruling transforms express trustee responsibilities under ERISA into automated stock buying or transferring mechanisms, without any fiduciary responsible for investment decisions that are prudent and in the best interests of plan participants and beneficiaries.

NELA agrees with the legal arguments made in Appellants' Brief, but this brief focuses on the District Court's legal error in eliminating the trustee responsibilities that flow from management and control of plan assets.[2] This error could have a devastating impact on employees' retirement savings and conflicts with ERISA's express provisions as well as its purpose. When the persons responsible for investment of pension assets fail to comply with ERISA's fiduciary responsibility provisions, the harm suffered by plan participants can be dramatic. In recent years, workers at companies like Enron and WorldCom have suffered huge losses to their retirement savings because plan fiduciaries breached their fiduciary duties in connection with 401(k) assets invested in employer stock. The District Court Ruling could result in no redress for plan participants when similar disastrous scenarios occur in the future.

This brief will address how the District Court's decision removing employer stock investments and offerings from ERISA's trustee responsibilities and accompanying fiduciary

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[2] Appellants' Brief contends, *inter alia*, that the District Court erred in determining that the Plan documents mandate investment in or the offering of Citigroup stock. NELA's position is that even if the Plan documents did mandate the investment in or offering of employer stock, they did not relieve the persons making investment decisions and investment option selections of their trustee responsibilities and fiduciary duties.

protections, where the plan mandates the investments or offerings, conflicts with 1) ERISA's purpose and policy, 2) ERISA's explicit statutory scheme, 3) the overwhelming majority of cases which have considered the duties of fiduciaries of plans investing in employer securities, and 4) the principles of trust law upon which the District Court purported to rely.

ARGUMENT

I. The District Court Ruling Violates ERISA's Purpose And Policy

ERISA is a comprehensive remedial statute designed to protect the interests of participants in employee benefit plans and their beneficiaries by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans. ERISA § 2(b), 29 U.S.C. § 1001(b). Congress recognized the need for "adequate . . . safeguards [to] be provided with respect to the establishment, operation, and administration of such plans." *Id.* § 2(a). ERISA also provides appropriate remedies and sanctions for violations of these fiduciary standards. *Id.* § 2(b). The District Court Ruling failed to recognize ERISA's heavy policy emphasis on protection of retirement assets through establishment of fiduciary standards even stronger than the standards of the common law of trusts.

More specifically, ERISA assigns fiduciaries a number of detailed duties and responsibilities, which include "the proper management, administration, and investment of [plan] assets, the maintenance of proper records, the disclosure of specified information, and the avoidance of conflicts of interest." *Mertens v. Hewitt Assoc.*, 508 U.S. 248, 251-52 (1993) (citing ERISA § 404(a), 29 U.S.C. § 1104(a)). ERISA's "central purpose" is to "protect beneficiaries of employee benefit plans." *Slupinski v. First Unum Life Ins. Co.*, 554 F.3d 38, 47 (2d Cir. 2009); *see also Salovaara v. Eckert*, 222 F.3d 19, 31 (2d Cir. 2000). Congress enacted

ERISA precisely to prevent the misuse and mismanagement of plan assets. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 140-43 n.8 (1985).

Rather than explicitly enumerating all of the powers and duties of trustees and other fiduciaries, "Congress invoked the common law of trusts to define the general scope of their authority and responsibility." *Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985). But significantly, and as the Supreme Court has recognized, "trust law does not tell the entire story." *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996). The Court explained in *Varity* that "ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection." *Id.* (citing ERISA § 2(a); H.R. Rep. No. 93-533, at 3-5, 11-13 (1973), 2 Leg. Hist. 2350-52, 2358-60; H.R. Rep. No. 93-1280, at 295, 302 (1974) (Conf. Rep.), 3 Leg. Hist. 4562, 4569). ERISA's protections are therefore often greater than the protections of the common law of trusts.

As stated by the Supreme Court in *Varity*, Congress expected that "the courts will interpret this prudent man rule (and the other fiduciary standards) bearing in mind the special nature and purpose of employee benefit plans," as they "develop a 'federal common law of rights and obligations under ERISA-regulated plans.'" 516 U.S. at 497 (some citations omitted; citing *Firestone Tire & Rubber Co. v. Bruch*, 489 U.S. 101, 110-11 (1989)). The Supreme Court concluded:

> Consequently, we believe that the law of trusts often will inform, but will not necessarily determine the outcome of, an effort to interpret ERISA's fiduciary duties. In some instances, trust law will offer only a starting point, after which courts must go on to ask whether, or to what extent, the language of the statute, its structure, or its purposes require departing from common-law trust requirements. And, in doing so, courts may have to take account of competing congressional purposes, such as Congress' desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system

> that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place.

516 U.S. at 497.

In enacting ERISA, Congress installed many requirements that are more exacting than the common law of trusts. *Donovan v. Mazzola*, 716 F.2d 1226, 1231-32 (9th Cir. 1983) (citing *Sinai Hosp. of Baltimore v. Nat'l Benefit Fund for Hosp. & Health Care Employees*, 697 F.2d 562, 565 (4th Cir.1982)). For example, ERISA's legislative history indicates that Congress intended to incorporate into Section 404 the "core principles of fiduciary conduct" that were developed in the common law of trusts, but with modifications appropriate for employee benefit plans. *Donovan v. Cunningham*, 716 F.2d 1455, 1464 (5th Cir. 1983). ERISA's modifications of existing trust law include imposition of duties upon a broader class of fiduciaries, 29 U.S.C. § 1002(21), prohibition of exculpatory clauses, *id.* § 1110(a), broad disclosure and reporting requirements, *id.* §§ 1021-31, and nationwide uniformity of rules. *See generally* H.R. Rep. No. 93-533, 1974 U.S.C.C.A.N. 4649-51; *Donovan*, 716 F.2d at 1464 n.15.

It is not surprising that when Congress enacted ERISA, it placed more constraints on the rights of plan sponsors than those accorded to settlors disposing of their own monies. In conventional trusts, settlors are generally free to distribute their own property as they see fit, and trust law protects the settlors' interest in disposing of their own property to the extent not contrary to law or public policy. ERISA, in contrast, protects employees' interests in receiving benefits owed to them as compensation under employee benefit plans associated with their employment. *See Steinman v. Hicks*, 352 F.3d 1101, 1103 (7th Cir.) (Posner, J.) ("[T]here are no free lunches; any benefit that an employer confers on an employee is reckoned by the employer as a cost and so affects the overall level of compensation that he is willing to pay."). For that reason, Congress significantly regulated the management and disposition of pension plan assets.

ERISA's legislative history includes precisely this point:

> [E]ven where the funding mechanism of the plan is in the form of a trust, reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries. This is because trust law had developed in the context of testamentary and inter vivos trusts (usually designed to pass designated property to an individual or small group of persons) with an attendant emphasis on carrying out the instructions of the settlor. Thus, if the settlor includes in the trust document an exculpatory clause under which the trustee is relieved from liability for certain actions which would otherwise constitute a breach of duty, or if the settlor specifies that the trustee shall be allowed to make investments which might otherwise be considered imprudent, the trust law in many states will be interpreted to allow the deviation. In the absence of a fiduciary responsibility section in the present Act, courts applying trust law to employee benefit plans have allowed the same kinds of deviations, even though the typical employee benefit plan, covering hundreds or even thousands of participants, is quite different from the testamentary trust both in purpose and in nature....It is expected that courts will interpret the prudent man rule and other fiduciary standards bearing in mind the special nature and purposes of employee benefit plans intended to be effectuated by the Act.

S. Rep. No. 93-127, at 29-30 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4865-66; H.R. Rep. No. 93-533, at 12-13, *reprinted in* 1974 U.S.C.C.A.N. 4639, 4649-51; *see also Eaves v. Penn,* 587 F.2d 453, 459-60 (10th Cir. 1978) (analyzing the legislative history of ERISA and reaching "the inexorable conclusion that ESOP fiduciaries are subject to the same fiduciary standards as any other fiduciary except to the extent that the standards require diversification of investments").

The District Court found that the persons with the control and authority over the assets of the Citigroup Plan had no discretion under the plan document and therefore "could not have been 'acting as fiduciaries' with respect to the Plans' investment in Citigroup stock." 2009 WL 2762708 at *1. In essence, the District Court found that with respect to the plans' investment in Citigroup stock, <u>there was no fiduciary</u>, and therefore ERISA's fiduciary duty and remedial provisions did not apply. The District Court ruling not only is contrary to the public policies underlying ERISA, as set forth below it eviscerates ERISA's statutory protections because it

allows a phrase in a plan to deprive participants of the very safeguards ERISA was enacted to provide.[3]

II. The District Court's Ruling Deprives Plan Participants Of The Protections Of Trusteed Plan Assets Which the Plain Language Of ERISA Requires

Under ERISA § 403, "all assets of an employee benefit plan shall be held in trust by one or more trustees." 29 U.S.C. § 1103. By this language, Congress ensured that some person or entity *must* be responsible for the control and management of a plan's assets. Yet the District Court held that no one had fiduciary responsibility for the plan's assets invested in employer stock, and that the duty to follow the terms of the plan trumped the duty of prudence. These holdings cannot be reconciled with the plain language of ERISA.

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[3] Federal public policy as embodied in longstanding Internal Revenue Code provisions also supports Plaintiffs' position. Notably, Section 401(a)(2) of the Internal Revenue Code provides that for a plan to qualify for favorable tax treatment, it must be "*impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries.*" 26 U.S.C. § 401(a)(2) (emphasis added); *see also id.* § 401(a)(1) (to be qualified, contributions must be made to the trust *for the purpose of distributing to such employees or their beneficiaries* the corpus and income of the fund accumulated by the trust) (emphasis added); *id.* § 1.401-2(a)(2) ("As used in section 401(a)(2), the phrase 'if under the trust instrument it is impossible' means that the trust instrument must definitely and affirmatively make it impossible for the nonexempt diversion or use to occur, whether by operation or natural termination of the trust, by power of revocation or amendment, by the happening of a contingency, by collateral arrangement, or by any other means . . .. [I]t must be impossible for the trust funds to be used or diverted for purposes other than for the exclusive benefit of his employees or their beneficiaries."); *id.* § 1.401-2(a)(3) ("As used in section 401(a)(2), the phrase 'purposes other than for the exclusive benefit of his employees or their beneficiaries' includes all objects or aims not solely designed for the proper satisfaction of all liabilities to employees or their beneficiaries covered by the trust."); *id.* § 1.401-1(a)(2)(i) ("A qualified pension, profit-sharing, or stock bonus plan is a definite written program . . . which is established and maintained by an employer . . . to provide for the livelihood of the employees or their beneficiaries after the retirement of such employees through the payment of benefits determined without regard to profits."); *id.* § 1.401-1(b)(5)(ii) ("Where trust funds are invested in stock or securities of . . . the employer . . . full disclosure must be made of the reasons for such arrangement and the conditions under which such investments are made in order that a determination may be made whether the trust serves any purpose other than constituting part of a plan for the exclusive benefit of employees.").

ERISA treats trustee responsibilities as a special category of fiduciary duties. It requires that a trustee holding plan assets be either "named in the trust instrument or in the plan instrument . . . or appointed by a person who is a named fiduciary" and that the trustee accept the appointment. *Id.* There are no casual or informal assignments of trustee responsibilities. Rather, "the trustee or trustees *shall have exclusive authority and discretion to manage and control the assets of the plan* except to the extent that the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary[4] who is not a trustee…" or "authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 1102(c)(3)." *Id.* (emphasis added).

ERISA defines "trustee responsibilities" in § 405(c)(3) as "any responsibility provided in the plan's trust instrument (if any) to manage or control the assets of the plan,[5] other than a power . . . to appoint an investment manager." ERISA § 405(c)(1) makes most fiduciary responsibilities delegable, but not "trustee responsibilities."

Thus, ERISA specifically requires that 1) all assets of an employee benefit plan be held in trust; 2) a trustee, named fiduciary or investment manager have the exclusive authority and discretion to manage and control the assets of the trust; and 3) the person with trustee responsibilities may not delegate those responsibilities.

The District Court Ruling ignores this statutory scheme. The District Court found that persons with control over plan assets "had no discretion – and could not have been 'acting as fiduciaries'- with respect to the Plans' investment in Citigroup stock." 2009 WL 2762708 at *1.

[4] The term "named fiduciary" means a fiduciary, as that term is defined in ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A), who is named in the plan document and who has "authority to control and manage the operation and administration of the plan." ERISA § 402(a), 29 U.S.C. § 1102(a).

[5] There is no dispute that employer securities held by a pension plan are plan assets. *See generally* ERISA § 3(42); 29 C.F.R. § 2510.3-101(a)(2).

Yet ERISA requires that the plans' investment in Citigroup stock be held in trust and that a fiduciary have the exclusive authority and discretion to manage and control the investment. The District Court Ruling leaves no one in charge of this entire class of plan assets.

The requirement that assets be held in trust, rather than in custodial accounts or escrows, reflects Congress's intent to impose specific fiduciary duties on those with responsibility for plan assets. ERISA § 3(21)(A) makes a fiduciary of any person with "*any* authority or control respecting management or disposition of [a plan's] assets." 29 U.S.C. § 1002(21)(A) (emphasis added). Because plan assets may be managed only by persons with fiduciary status, all decisions involving the management or disposition of plan assets are subject to ERISA's fiduciary responsibility rules. *See Lowen v. Tower Asset Mgmt.*, 829 F.2d 1209, 1218-19 (2d Cir. 1987).

This Court has described the fiduciary duties set forth in ERISA § 404(a) as being "the highest known to the law." *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982). Section 404(a) provides in pertinent part:

> (a) Prudent man standard of care
>
> (1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and--
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) 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;
>
> ***
>
> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

29 U.S.C. § 1104(a).

Significantly, § 404(a)(1)(D) provides that plan fiduciaries are to comply with plan documents only "insofar as such documents and instruments are consistent with the provisions of this subchapter…." The "provisions of this subchapter," i.e., Subchapter I of ERISA, include both the duties to hold the assets in trust and to have a trustee in charge of the management and disposition of the assets, as well as the prudent man standards set forth in § 404(a)(1). Accordingly, fiduciaries are bound to disregard any plan provision that allows plan investments to be held without investment management by a person with trustee responsibilities or any provision that allows imprudent investment of plan assets or disloyalty to plan participants in violation of ERISA §§ 404(a)(1)(A)&(B). Thus, notwithstanding the language of the plan document, the trustees of eligible individual account plans ("EIAPs"), or any named fiduciaries or investment managers who direct such trustees, must exercise their trustee responsibilities in deciding whether to invest in employer securities consistent with the fiduciary duties of prudence and loyalty in ERISA § 404(a).

ERISA § 410(a) repeats § 404(a)(1)(D)'s elevation of the duties of prudence and loyalty over plan terms. Section 410(a) states that except as provided in subsections not pertinent here, "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 shall be void as against public policy." 29 U.S.C. § 1110(a). Under the District Court's interpretation, language mandating investment in employer stock which removes the investment from management by a fiduciary and removes any oversight as to whether the investment is prudent or in the best interests of plan participants overrides ERISA's statutory provisions to the contrary. ERISA § 410(a) states plainly that this is contrary to public policy.

ERISA §§ 404(a)(1)(D) and 410(a) both prohibit the enforcement of plan terms which purport to remove trusteed plan assets from fiduciary management including ERISA's prudent man standard of care. As the Supreme Court held in *Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc.*, 472 U.S. 559, 568 (1985), "trust documents cannot excuse trustees from their duties under ERISA, and [] trust documents must generally be construed in light of ERISA's policies." (Citing 29 U.S.C. § 1104(a)(1)(D)); *see also Laborers Nat. Pension Fund v. N. Trust Quantitative Advisors, Inc.*, 173 F.3d 313, 322 (5th Cir. 1999) ("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."); *Best v. Cyrus*, 310 F.3d 932 (6th Cir. 2002) (plan document purporting to limit trustee's duties to specified acts was inconsistent with ERISA and could not "excuse" the trustee from his fiduciary duties).

Contrary to ERISA's statutory scheme which requires that all plan investments be managed by trustees subject to fiduciary duties of prudence and loyalty that are the highest known to law, the District Court Ruling deprives plan participants of these statutory protections by enabling plan sponsors to write them out of the plan.

III. The District Court Ruling Conflicts With Twenty Years of Judicial Analysis

Numerous courts have held that EIAPs or ESOPs may not mandate non-diversification in all instances where such mandates otherwise conflict with ERISA's duties of prudence (but not its diversification requirement) and loyalty. Notably, the Sixth Circuit has held that "the purpose and nature of ERISA and ESOPs preclude a plan's *per se* prohibition against diversification or liquidation." *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir. 1995) (emphasis added). The court stated:

> [T]he purpose of ESOPs cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit plans. Therefore, a plan

> provision that completely prohibits diversification of ESOP assets necessarily violates the purposes of ERISA. ERISA provides that a fiduciary may only follow plan terms to the extent that the terms are consistent with ERISA. 29 U.S.C. § 1104(a)(1). In [*Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995)], the Third Circuit held that a fiduciary's argument that he was prohibited from diversifying an ESOP under the terms of the plan that he administered was untenable because it was "inconsistent with ERISA inasmuch as it constrain[ed] the [fiduciary's] ability to act in the best interest of the beneficiaries." *Moench*, 62 F.3d at 567. We agree and thus reject defendants' argument that the Plan provisions left them no discretion to diversify.

Id. (some citations omitted).

As one district court has noted, "[t]here are two important points to be gleaned from *Kuper*." *Rankin v. Rots*, 278 F.Supp.2d 853, 879 (E.D.Mich. 2003). First, the fact that a Plan requires investment in employer stock will not *ipso facto* relieve the fiduciaries of their obligations to prudently invest or to diversify. Second, "whether or not they have breached their fiduciary duties requires development of the facts of the case." *Id.*[6]

The Ninth Circuit has explained that "Congress expressly intended that the ESOP would be both an employee retirement benefit plan and a technique of corporate finance that would encourage employee ownership." *Johnson v. Couturier*, 572 F.3d 1067, 1076 (9th Cir. 2009) (citing *Edgar v. Avaya, Inc.*, 503 F.3d 340, 346 (3d Cir. 2007)). Although the creation of ESOPs necessitated their exemption from certain ERISA requirements, such as asset diversification, the court reasoned, "the core fiduciary duties of loyalty and care as well as the prohibition against self-dealing remain in effect." *Id.*

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[6] It is significant that *Kuper*, *Moench*, and *Edgar* run completely counter to the District Court's holding that plan mandates relieve EIAP fiduciaries of fiduciary responsibility. The District Court embraced the so-called "*Moench* presumption" applied in these cases, that an ESOP's investment in employer stock is presumptively prudent, subject to rebuttal. 2009 WL 2762708, *15. This Court has never adopted this presumption, and NELA fully agrees with Appellants that the Court should not do so now. However, it is impossible to reconcile the District Court's reliance on this presumption with *Kuper's* holding that "a plan provision that completely prohibits diversification of ESOP assets necessarily violates the purposes of ERISA." *Kuper*, 66 F.3d at 1457.

Numerous other courts have made precisely this point. *See Eaves , 587* F.2d 453, 459 (10th Cir. 1978) ("While an ESOP fiduciary may be released from certain Per se violations on investments in employer securities . . . the structure of [ERISA] itself requires that in making an investment decision of whether or not a plan's assets should be invested in employers securities, an ESOP fiduciary, just as fiduciaries of other plans, is governed by the 'solely in the interest' and 'prudence' tests of §§ 404(a)(1)(A) and (B)."); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983) ("Though freed by Section 408 from the prohibited transaction rules, ESOP fiduciaries remain subject to the general regulations of Section 404."); *Fink v. Nat'l Sav. & Trust Co.*, 772 F.2d 951, 955-56 (D.C. Cir. 1985) ("[T]he requirement of prudence in investment decisions and the requirement that all acquisitions be solely in the interest of plan participants continue to apply" in the EIAP context.); *Edgar.*, 503 F.3d 340, 346 (3d Cir. 2007) ("[W]e emphasized [in *Moench*] that ESOP fiduciaries are still required to act in accordance with the duties of loyalty and care that apply to fiduciaries of typical ERISA plans."); *In re Syncor ERISA Litig.*, 516 F.3d 1095, 1102 (9th Cir. 2008) ("29 U.S.C. § 1104(a)(2) does not exempt [EIAP] fiduciaries from the first prong of the prudent man standard, which requires a fiduciary to act with care, skill, prudence, and diligence in any investment the fiduciary chooses.").[7]

The Seventh Circuit has addressed this concept in detail:

> The duty to diversify is an essential element of the ordinary trustee's duty of prudence, given the risk aversion of trust beneficiaries, but the absence of any general such duty from the ESOP setting does not eliminate the trustee's duty of prudence. If anything, it demands an even more watchful eye, diversification not being in the picture to buffer the risk to the beneficiaries should the company encounter adversity. There is a sense in which, because of risk aversion, an ESOP is imprudent per se, though legally authorized. This built-in "imprudence" (for

[7] *See also Ershick v. Greb X-Ray Co.*, 705 F.Supp. 1482, 1487 (D.Kan. 1989); *In re Enron Corp. Securities, Derivative & ERISA Litig.*, 284 F.Supp.2d 511, 534 (S.D.Tex. 2003); *In re Sprint Corp. ERISA Litig.*, 388 F.Supp.2d 1207, 1223 (D.Kan. 2004).

> which the trustee is of course not culpable) requires him to be especially careful to do nothing to increase the risk faced by the participants still further.
>
> ***
>
> A trustee who simply ignores changed circumstances that have increased the risk of loss to the trust's beneficiaries is imprudent. Whether that is an accurate characterization of LaSalle's conduct is a critical issue requiring exploration by the district court.

Armstrong v. LaSalle Bank Nat. Ass'n, 446 F.3d 728, 732-34 (7th Cir. 2006) (Posner, J.).

Finally, two previous New York district court decisions recognized the primacy of fiduciary duties over plan terms. Plan documents in *In re Polaroid ERISA Litigation*, 362 F.Supp.2d 461 (S.D.N.Y. 2005), mandated that employer stock be an investment alternative. The court held that "ERISA commands fiduciaries to obey Plan documents only to the extent they are consistent with other fiduciary duties," and that "compliance with the terms of the plan does not, by itself, satisfy ERISA's imperatives." *Id.* at 473-74 (citing *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 1997 WL 278116, at *2 (S.D.N.Y. May 23, 1997) ("[A]n ERISA fiduciary cannot 'hide' behind the terms of a contract to insulate itself from liability for breaching its fiduciary duty.")). The court concluded that "[b]y force of statute, Defendants had the fiduciary responsibility to disregard the Plan and eliminate Plan investments in Polaroid stock if the circumstances warranted." *Id.* at 474 (citing 29 U.S.C. § 1104(a)(1)(D)). To the extent that company stock was an imprudent investment, fiduciaries "possessed the authority as a matter of law to exclude Polaroid stock from the ESOP or as a 401(k) investment alternative, regardless of the Plan's dictates." *Id.* at 474-75.

Likewise, in *Agway, Inc., Employees' 401(k) Thrift Investment Plan v. Magnuson*, 2006 WL 2934391, at *18 (N.D.N.Y. Oct. 12, 2006), the court concluded that the exact argument adopted by the District Court here "misapprehends the nature of the fiduciary duty owed [] to the Plan and its participants." The court observed that "[n]othing in ERISA . . . requires blind

compliance with plan terms which would require a fiduciary to engage in imprudent conduct." *Id.* Instead, ERISA fiduciaries owe allegiance to the terms of a plan document only insofar as such documents and instruments are consistent with the provisions of ERISA. Indeed, the court ruled, "ERISA casts upon fiduciaries an affirmative, overriding obligation to reject plan terms where those terms would require such imprudent actions in contravention of the fiduciary duties imposed under ERISA." *Id.* (citing multiple authorities). The court concluded that "plan fiduciaries implementing language directing the purchase of employer securities must nonetheless exercise the degree of loyalty and prudence owed by a fiduciary in determining whether to carry out that directive." *Id.* (citing multiple authorities).

NELA urges the Court not to adopt the outlier position of the District Court Ruling, which would negate swaths of fiduciary duties, and instead to join with the courts above in recognizing that the duties of prudence and loyalty still apply where a plan mandates an investment or offering of employer stock.

IV. The District Court's Ruling Conflicts With Trust Law Principles

As explained in Part I of this brief, ERISA draws on trust law in establishing standards of conduct for fiduciaries. ERISA protects employees by setting forth certain general fiduciary duties applicable to the management of both pension and non-pension benefit plans. *Varity Corp.*, 516 U.S. at 496 (citing ERISA § 404). These fiduciary duties draw much of their content from the common law of trusts, but they also "reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection." *Id.* at 497 (citing ERISA § 2(a); H.R. Rep. No. 93-533, at 3-5, 11-13 (1973), 2 Leg. Hist. 2350-52; 2358-60; H.R. Rep. No. 93-1280, at 295, 302 (1974) (Conf. Rep.), 3 Leg. Hist. 4562, 4569). For this reason, ERISA's protections are therefore often greater than the protections of the common law of trusts.

Yet even if ERISA's protections were no greater than the common law of trusts, the District Court wrongly concluded that trust law supported its holding that fiduciaries must follow mandatory plan language regardless of the impact on plan assets. The District Court cited one source, § 91(b) of the Restatement (Third) of Trusts, in support of its ruling. According to the District Court, § 91(b) demonstrates that at common law, trustees must follow trust terms that mandate investment in specified assets. 2009 WL 2762708, *10. While this may be the general rule under traditional trust law, the District Court failed to substantively address the important exceptions that would preclude application of this principle here.

Section 91(b) provides that in investing trust funds, a trustee "has the powers expressly or impliedly granted by the terms of the trust and, *except as provided in §§ 66 and 76*, has a duty to conform to the terms of the trust directing or restricting investments by the trustee." Restatement (Third) of Trusts § 91(b) (2007) (emphasis added). Section 66(1) provides that courts may modify a trust, or direct or permit a trustee to deviate from a trust provision, if "because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust." *Id.* § 66(1). Section 66(2) provides:

> If a trustee knows or should know of circumstances that justify judicial action under Subsection (1) with respect to an administrative provision, and of the potential of those circumstances to cause substantial harm to the trust or its beneficiaries, the trustee has a duty to petition the court for appropriate modification of or deviation from the terms of the trust.

Id. § 66(2).

While the District Court acknowledged these provisions, it dismissed them solely by noting erroneously that "[t]hose concepts are not present in ERISA." 2009 WL 2762708, *11 n.3. However, ERISA has a civil enforcement scheme that allows a fiduciary (as well as the Secretary of Labor or a participant or beneficiary) to seek various forms of equitable relief from

the courts. 29 U.S.C. § 1132(a). In *Varity*, for instance, the Supreme Court granted equitable relief to a group of participants in the form of reinstatement in their former plan in order to remedy fiduciary misrepresentations that had induced them to leave.

Thus, under the Restatement, trustees have a *duty* to act when circumstances have the potential to cause substantial harm to a trust or its beneficiaries. ERISA also provides regulatory and civil enforcement protections to assure the protection of plan participants' interests. Restatement § 91(b), the sole trust law support cited by the District Court, also includes a second exception, one based on Restatement § 76. Section 76 in pertinent part provides that "[t]he trustee has a duty to administer the trust, diligently and in good faith, in accordance with the terms of the trust *and applicable law*." Restatement (Third) of Trusts § 76(1) (emphasis added). The Restatement thus binds trustees to comply with the law, not just the trust's terms. Faithful application of the whole of Restatement § 91 to the acts at issue in this case, therefore, would dictate that the plans did not constrain the fiduciaries to remain idle where ERISA's duty of prudence required action.

In addition, a Restatement Comment states that restrictions on trustee investment are "ordinarily binding" "[u]nless violative of some public policy." *See, e.g.*, *id.* § 76 cmt. b(1); *Id.* § 27 cmt. b; *id.* § 29 cmt. m; Reporter's Notes to those Comments; i*d.* § 91 cmt. e. Comment (b)(1) to § 76 in turn reiterates that trustees normally may not comply with trust terms that are against public policy, and again emphasizes the duty of trustees to comply with the law:

> A trustee has both (i) a duty generally to comply with the terms of the trust and (ii) a duty to comply with the mandates of trust law except as permissibly modified by the terms of the trust. Because of this combination of duties, the fiduciary duties of trusteeship sometimes override or limit the effect of a trustee's duty to comply with trust provisions; conversely, the normal standards of trustee conduct prescribed by trust fiduciary law may, at least to some extent, be modified by the terms of the trust . . .. The normal duty of a trustee to obey the

> terms of the trust also does not apply to provisions that are invalid because they are unlawful or against public policy.[8]

Id. § 76 cmt. b(1).

Judicial interpretation of trust law follows the approach of the Restatement of Trusts discussed above: courts do not apply settlors' intentions when they are contrary to law or public policy. *See Gilbert v. Gilbert*, 350 N.E.2d 609 (N.Y. 1976) ("[I]n construing an *inter vivos* trust, effect is to be given to that intention unless it is contrary to public policy or law."); *Oakes v. Muka*, 818 N.Y.S.2d 647, 649 (N.Y. App. Div. 2006) ("[C]ourts will, in construing a living trust, seek to honor the settlor's intent unless, among other things, it is contrary to public policy…").

Finally, this Court's gloss on the Restatement of Trusts bears consideration when evaluating the Restatement's significance in construing ERISA:

> The fiduciary obligations of the trustees to the participants and beneficiaries of the plan are those of trustees of an express trust – the highest known to the law. Restatement of Trusts 2d s 2, comment b (1959).

Donovan v. Bierwirth, 680 F.2d 263, 272 n.8 (2d Cir.1982). This Court in *Bierwirth* also cited several trust law sources for the proposition that fiduciary decisions "must be made with an eye single to the interests of the participants and beneficiaries." *Id.* at 271 (citing Restatement (Second) of Trusts § 170 (1959); II *Scott on Trusts* § 170, 1297-99 (1967) (citing cases and authorities); George Gleason Bogert, *The Law of Trusts and Trustees* § 543 (2d ed. 1978)). The District Court's reliance on the common law of trusts to relieve the plans' fiduciaries of their responsibilities was doubly misplaced, as both an erroneous reading of trust law and as a failure

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[8] As discussed elsewhere, ERISA itself is fully consistent with the Restatement on this point. ERISA § 404(a)(1)(D) provides that plan fiduciaries are to comply with plan documents only "insofar as such documents and instruments are consistent with the provisions of this subchapter . . ." and ERISA § 410(a) states in pertinent part that "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 shall be void as against public policy." 29 U.S.C. § 1110(a).

to recognize ERISA's greater protections to participants' interests than to a settlor's intent. The fiduciary obligations of trustees – "the highest known to law" – are the very essence of ERISA.

CONCLUSION

For the reasons stated above, NELA respectfully requests that this Court reverse the District Court's decision and remand the case to the district court for further proceedings.

Dated: December 23, 2009

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December 23, 2009

Ellen M. Doyle

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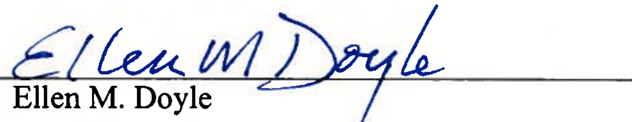

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