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Revisiting the *Moench* Presumption 15 Years Later; Are the Courts Barking Up the Wrong Tree?

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Class action lawsuits challenging fiduciaries' purchase and retention of employer securities in tax code Section 401(k) plans came into vogue with the stock market crash of 2001. Since then, literally hundreds of plan fiduciaries have been on the receiving end of these ''stock-drop'' claims and the federal courts have issued scores of decisions, mostly in response to the fiduciaries' motions to dismiss. Despite the common claims and underlying legal theories in these cases, there has been little uniformity in the judicial decisions, aside from the fact that all of the final adjudications on the merits have, so far, favored defendants.

The largest share of these decisions has attempted to apply the U.S. Court of Appeals for the Third Circuit's decision in *Moench v. Robertson*[1] to the claims with widely varying results, sometimes leading to different outcomes on substantially identical facts. This article examines *Moench* and the lack of uniformity in its application to stock-drop litigation and suggests an alternative approach to evaluating these claims that is based on the governing statutes rather than judicial interpretations of congressional intent and the common law of trusts (For a perspective from plaintiffs' attorneys on this issue, *see* 174 PBD, 9/10/10; 37 BPR 2041, 9/14/10).

This article does not address decisions that have dismissed stock-drop claims without relying on *Moench*, including cases holding that fiduciaries have no discretion (or duty) where employer securities are ''hard-wired'' into a plan, and cases holding that claims for failing to sell employer securities are ill-disguised diversification claims prohibited under Employee Retirement Income Security Act (''ERISA'') Section 404(a)(2).

Since the topic of this article is *Moench* and its progeny, the logical place to start is with the Third Circuit's decision.

Moench v. Robertson

Statewide Bancorp (''Statewide'') was a bank holding company that sponsored an employee stock ownership plan (''ESOP'') designed to primarily invest in Statewide common stock. In 1989, the value of Statewide stock, which was trading around $18, fell by approximately 50 percent. The stock price continued to fall in 1990 and the first half of 1991, until it sank to 25 cents per share in May 1991. During the stock's decline, federal regulators repeatedly criticized the bank's capital ratios, credit practices, and loan portfolio. On May 22, 1991, federal regulators took control of one of Statewide's two bank subsidiaries and Statewide filed for Chapter 11 bankruptcy the next day.

[1] 62 F.3d 553, 19 EBC 1713 (3d Cir. 1995).

A former Statewide employee and ESOP participant named Charles Moench sued in 1992, alleging that the ESOP's fiduciaries breached their ERISA duties of prudence and loyalty by continuing to invest the ESOP in Statewide stock despite their knowledge of Statewide's declining financial condition. The U.S. District Court for the District of New Jersey granted the defendants' motion for summary judgment and dismissed the claims, holding that the ESOP's terms did not give its fiduciaries discretion to invest the ESOP in anything other than Statewide stock.

On appeal, the Third Circuit confronted ''the difficult question'' of whether fiduciaries could be held liable under ERISA for investing in employer securities when both Congress and the terms of the ESOP provided that the ''primary purpose of the plan'' was to invest in employer securities.[2] To answer the question, the court began by noting that under ERISA Section 404(a)(2), ESOP fiduciaries are exempt from the fiduciary duty of diversification—and from ERISA's prudence requirement to the extent that it requires diversification—for their investments in employer securities.[3] The court attributed the statutory exemption to the ''nature and purpose of ESOPs themselves''—''to invest primarily in qualifying employer securities''—and observed that ''ESOPs, unlike pension plans, are not intended to guarantee retirement benefits'' but are designed to further the goal of employee ownership, even at heightened risk to ESOP participants.[4]

The court did not stop there, however (and as set forth below, the authors believe that it probably should have). Instead, the court found that—''[n]otwithstanding all of this''—ESOPs were still subject to ERISA's fiduciary duties of loyalty and care.[5] On this point, the court admitted confusion: ''[a]ll of this makes delineating the responsibilities of ESOP trustees difficult'' because of the need to balance the congressionally-sanctioned goal of employee ownership against ERISA's duties of loyalty and care, to ''find a way for the competing concerns to coexist.''[6]

To achieve this balancing, the court looked to the common law of trusts because in the court's view, ''when an ESOP is created, it becomes simply a trust under which the trustee is directed to invest the assets primarily in the stock of a single company'' and serves a purpose ''explicitly approved and encouraged by Congress.''[7] Under the law of trusts, a duty to diversify can be waived by a trust's terms. Thus, ERISA's express exemption of ESOPs from the duty to diversify is a statutory recognition of the terms of ESOP trusts.[8]

Its excursion into trust law well under way, the court observed that a trustee has a duty to the trust's beneficiaries to conform its investment decisions to the trust's terms and the settlor's direction. These directions, however, could either be mandatory or discretionary. In the case of mandatory investments, a trustee must comply unless compliance is impossible or illegal. In the case of a permitted investment, ''the fiduciary must still exercise care, skill, and caution in making decisions to acquire or retain the investment.''[9]

The court's survey of hornbook trust law now complete, it set out to address the facts before it, ''in which a fiduciary is not absolutely required to invest in employer securities but is more than simply permitted to make such investments.''[10] The court noted that, while the fiduciary was ''presumptively'' required to invest in employer stock, ''there may come a time'' when such investment no longer serves the trust's purposes or the settlor's intent.[11] The court decided that in such cases it should not immunize a fiduciary from judicial inquiry but should not subject the fiduciary to *de novo* review. The court determined that an abuse of discretion standard was the ''most logical result.''[12]

The court then (in the view of the authors) further confused the issue by announcing that the abuse of discretion standard would be implemented by affording an ESOP fiduciary who invests in employer securities a presumption that the investment was prudent and the presumption should take into account the degree of discretion given to the fiduciary under the plan.[13] A plaintiff could rebut this presumption by establishing that the fiduciary abused this discretion through a showing that the fiduciary could not have ''believed reasonably that continued adherence to the ESOP's direction was in keeping with the settlor's expectations of how a prudent trustee would operate.''[14]

Thus, the Third Circuit tied its newly minted presumption of prudence not to the governing statutes but rather to congressional intent to encourage employee ownership and the common law of trusts, which ultimately depends on the language of the trust document before the court in any given case.

Courts Jump on the *Moench* Bandwagon

Two months after *Moench* was decided, the U.S. Court of Appeals for the Sixth Circuit embraced it in *Kuper v. Iovenko*:[15] ''We agree with and adopt the Third Circuit's holding that a proper balance between the purpose of ERISA and the nature of ESOPs requires that we review an ESOP fiduciary's decision to invest in employer securities for an abuse of discretion. In this

[2] *Id.* at 556.
[3] *Id.* at 568.
[4] *Id.* at 569.
[5] *Id.*
[6] *Id.* at 570.
[7] *Id.* at 571.
[8] *Id.*

[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.* The *Moench* court cautioned future courts that when applying the presumption, they should be mindful of the possibility that fiduciaries could face liability for *not* maintaining the investment in employer securities, especially if the stock price increases after divestment. *Id.* at 571-72. The court also commented on the fact that ESOP fiduciaries who ''double as directors of the corporation'' often serve ''two masters'' when the company's financial condition deteriorates, and ''the more uncertain the loyalties of the fiduciary, the less direction it has to act.'' *Id.* at 572. The court said in such a scenario, prudence requires ''a careful and impartial investigation of all investment decisions.'' *Id.* Applying its new test, the court held that summary judgment for defendants was inappropriate because the record was incomplete as to whether the ESOP's fiduciaries ''properly could effectuate the purposes of the trust only by deviating from the trust's direction or by contracting out investment decisions to an impartial outsider.'' *Id.* The case was remanded to the district court. *Id.*
[15] 66 F.3d 1447, 1459, 19 EBC 1969 (6th Cir. 1995).

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regard, we will presume that a fiduciary's decision to remain invested in employer securities was reasonable.'' The *Kuper* court then held that the presumption could be rebutted by showing that a prudent fiduciary contemplating similar circumstances would have made a different investment decision, which sounds a lot like the nondeferential prudence standard in ERISA Section 404(a)(1)(B).[16]

There were relatively few cases requiring the courts to consider the proper treatment of employer securities under ERISA's fiduciary rules until the stock market bubble burst in 2000 and stock prices dropped sharply. Then, as now, many publicly traded companies sponsored tax code Section 401(k) plans that held stock of the plan sponsor and these plans quickly became targets of ''401(k) stock-drop'' suits that usually followed securities fraud actions against the plan sponsors and largely parroted their allegations.[17]

These Section 401(k) stock-drop claims typically alleged that the employer securities held by the plans were artificially inflated in price (again parroting the securities fraud claims) and that the defendant fiduciaries had a duty to sell them before the disclosure of true facts had eliminated the artificial inflation and caused the price to drop.[18] In effect, these lawsuits contended that these fiduciaries had a duty to take advantage of the alleged fraud on the market for the benefit of the plan participants.[19]

The defendants usually responded with Federal Rule of Civil Procedure 12 motions seeking dismissal on a variety of legal theories and, as the courts began to rule, three theories emerged.

Some courts, led by the U.S. Court of Appeals for the Ninth Circuit's suggestion, held that Section 404(a)(2) precludes a claim that fiduciaries should have sold employer securities before the drop in price because these claims are simply arguments that the defendants had a duty to diversify the employer securities and conflicted with the language of the statute.[20] Other courts have, especially recently, held that where the plan requires by its terms investment in employer securities, the fiduciaries do not have the authority to sell and cannot be held liable under ERISA for failing to do so.[21] But the largest number of stock-drop decisions by far has embraced the *Moench* presumption and applied it to the plaintiffs' claims with widely divergent results.

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[16] *Id.*

[17] *See, e.g.*, Brett Nelson, *Open Season on 401(k)s: Lawyers Line Up to Sue Employers With Thrift Plans*, FORBES, Nov. 25, 2002 at 60 (as of article date, 115 lawsuits against 35 companies).

[18] This is an admittedly truncated summary of typical stock-drop claims. Plaintiffs often also contended that defendants should have disclosed the artificial inflation then sold the stock, and/or caused the plan to cease purchasing additional shares. However, in most cases potential damages are maximized by a claim that all employer stock held by the plan should have been sold before the drop in price and therefore the fiduciaries are liable for the price drop. As such, that is by far the most commonly (and forcefully) asserted claim.

[19] Several courts have held or suggested that fiduciaries have no obligation under ERISA to trade employer securities based on nonpublic ''inside'' information. *Harzewski v. Guidant Corp.*, 489 F.3d 799, 808, 40 EBC 2409 (7th Cir. 2007) (109 PBD, 6/7/07; 34 BPR 1384, 6/12/07) (''It probably would have been unlawful, moreover, for Guidant to sell the Guidant stock held by the pension plan on the basis of inside knowledge of the company's problems. If so, there are no damages, and indeed no breach of fiduciary duty; for the fiduciary's duty of loyalty does not extend to violating the law.''); *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 256, 43 EBC 2281 (5th Cir. 2008) (82 PBD, 4/29/08; 35 BPR 1034, 5/6/08) (insider trading ''is prohibited by securities laws. Fiduciaries may not trade for the benefit of plan participants based on material information to which the general shareholding public has been denied access.''); *Harris v. Amgen Inc.*, No. CV 07-5442 PSG (PLAx), 2010 WL 744123, at *12, 48 EBC 2153 (C.D. Cal. Mar. 2, 2010) (41 PBD, 3/4/10; 37 BPR 520, 3/9/10) (''eliminating the Amgen investment option may have violated federal securities laws because the decision would have been based on inside information.''); *In re Avon Prods. Inc. ERISA Litig.*, No. 05 Civ. 6803, 2009 WL 848083, at *15, 46 EBC 1769 (S.D.N.Y. Mar. 3, 2009) (41 PBD, 3/5/09; 36 BPR 569, 3/10/09) (magistrate recommendation) (''if the plan fiduciary disclosed any arguably material adverse information to the participants, precipitating a rash of selling, that would likely cause a sharp decline in the share price, thus damaging the Plan . . .''), *adopted by district court*, 2009 WL 884687, 46 EBC 1786 (S.D.N.Y. Mar. 30, 2009) (60 PBD, 4/1/09; 36 BPR 860, 4/7/09); *Lingis v. Motorola Inc.*, 649 F. Supp. 2d 861, 876, 47 EBC 1099 (N.D. Ill. 2009) (116 PBD, 6/19/09; 36 BPR 1506, 6/23/09) (''requiring disclosure of non-public information to plan beneficiaries when the information has not been provided to the market generally may run afoul of the insider trading laws.''), *appeal docketed*, No. 09-2796 (7th Cir. July 15, 2009); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-6297, 2008 WL 5234281, at *9, 45 EBC 1977 (W.D.N.Y. Dec. 12, 2008) (240 PBD, 12/16/08; 35 BPR 2925, 12/30/08) (''Further, had defendants released any adverse information they had . . . in advance of informing the market, such a disclosure to the Plan Participants before the information was disclosed to the public would have been in violation of the federal securities law that prohibit trading on nonpublic adverse information.''); *In re McKesson HBOC Inc. ERISA Litigation*, No. 00-20030, 2002 WL 31431588, at *6, 29 EBC 1229 (N.D. Cal. Sept. 30, 2002) (206 PBD, 10/24/02; 29 BPR 2863, 10/29/02) (''Fiduciaries are not obligated to violate the securities laws in order to satisfy their fiduciary duties.''). This defense is not addressed in this paper, which is limited to discussion of a fiduciary's statutory duty under ERISA Section 404(a)(2).

[20] *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1097, 32 EBC 1417 (9th Cir. 2004) (49 PBD, 3/15/04; 31 BPR 618, 3/16/04) (subjecting ''EIAPs to an albeit tempered duty to diversify arguably threatens to eviscerate congressional intent and the guiding rationale behind EIAPs themselves.''); *In re Beazer Homes USA Inc. ERISA Litig.*, No. 07-0952, 2010 U.S. Dist. LEXIS 33476, *19-20, 49 EBC 1791 (N.D. Ga. Apr. 2, 2010) (67 PBD, 4/9/10; 37 BPR 848, 4/13/10); *Mellot v. ChoicePoint Inc.*, 561 F. Supp. 2d 1305, 1311-12 (N.D. Ga. 2007); *Smith v. Delta Air Lines Inc.*, 422 F. Supp. 2d 1310, 1327, 37 EBC 1968 (N.D. Ga. 2006) (77 PBD, 4/21/06; 33 BPR 1043, 4/25/06); *Pedraza v. Coca-Cola Co.*, 456 F. Supp. 2d 1262, 1274-75, 39 EBC 2257 (N.D. Ga. 2006) (204 PBD, 10/24/06; 33 BPR 2593, 10/31/06); *In re McKesson HBOC Inc. ERISA Litig.*, No. 00-20030, 2002 WL 31431588, at *5, 29 EBC 1229 (N.D. Cal. Sept. 30, 2002) (206 PBD, 10/24/02; 29 BPR 2863, 10/29/02).

[21] *See, e.g.*, *In re Wachovia Corp. ERISA Litig.*, No. 3:09-cv-262, 2010 WL 3081359, at *9-11 (W.D.N.C. Aug. 6, 2010) (152 PBD, 8/10/10; 37 BPR 1829, 8/17/10); *In re Citigroup ERISA Litig.*, No. 07 Civ. 9790, 2009 WL 2762708, at *7-8, 47 EBC 2025 (S.D.N.Y. Aug. 31, 2009) (167 PBD, 9/1/09; 36 BPR 2054, 9/8/09); *Urban v. Comcast Corp.*, No. 08-773, 2008 WL 4739519, at *12, 45 EBC 1161 (E.D. Pa. Oct. 28, 2008) (212 PBD, 11/3/08; 35 BPR 2498, 11/4/08); *see also Kirschbaum*, 526 F.3d at 250, 256 (holding that defendant fiduciaries did not have the discretionary authority under the plan to remove Reliant stock because it was ''hard-wired'' into the plan but finding that documents extrinsic to the plan created ambiguity as to whether the fiduciaries actually had discretion over the employer securities).

Most Courts Adopt *Moench*, But Disagree on How to Apply It

Virtually all of the decisions applying *Moench* uncritically adopt the Third Circuit's reasoning and accept the fact that the prudence presumption should be applied, but that is where the commonality ends. Several courts apply the presumption in response to a defendant's Rule 12 motion and require that a plaintiff plead facts sufficient to overcome the presumption.[22] Other courts have treated it as an ''evidentiary'' presumption and held that it is inappropriate to apply it on a Rule 12 motion before the evidence is discovered and presented.[23] Another group of courts applies it only to plans that formally call themselves ESOPs in deference to the extensive discussion of the legislative history favoring employee ownership through ESOPs in the *Moench* decision.[24] Yet another group applies it to all ''eligible individual account plans'' including ESOPs.[25]

In addition to these differences, few courts seem to agree on exactly what a plaintiff has to do to overcome the presumption. Some hold that a plaintiff need only plead facts showing that ''a hypothetical prudent fiduciary would have acted otherwise'',[26] which is the normal, somewhat vague, nondeferential standard of prudence applicable to fiduciary conduct under ERISA Section 404(a)(1)(B). Others hold that a plaintiff has to plead facts showing that the plan sponsor faced imminent financial collapse,[27] causing one magistrate judge,

[22] *See, e.g., Ward v. Avaya Inc.*, 299 F. App'x 196, 45 EBC 1449 (3d Cir. 2008) (220 PBD, 11/14/08; 35 BPR 2601, 11/18/08); *Edgar v. Avaya Inc.*, 503 F.3d 340, 41 EBC 2249 (3d Cir. 2007) (187 PBD, 9/27/07; 34 BPR 2365, 10/2/07); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 32 EBC 1417 (9th Cir. 2004) (49 PBD, 3/15/04; 31 BPR 618, 3/16/04); *In re Wachovia Corp. ERISA Litig.*, No. 3:09-cv-262, 2010 WL 3081359 (W.D.N.C. Aug. 6, 2010) (152 PBD, 8/10/10; 37 BPR 1829, 8/17/10); *In re RadioShack ERISA Litig.*, 547 F. Supp. 2d 606, 43 EBC 2059 (N.D. Tex. 2008) (66 PBD, 4/7/08; 35 BPR 779, 4/8/08); *In re Avon Prods. Inc. ERISA Litig.*, No. 05-6803, 2009 WL 848083, 46 EBC 1769 (S.D.N.Y. Mar. 3, 2009) (41 PBD, 3/5/09; 36 BPR 569, 3/10/09) (magistrate recommendation), *adopted by district court*, 2009 WL 884687, 46 EBC 1786 (S.D.N.Y. Mar. 30, 2009) (60 PBD, 4/1/09; 36 BPR 860, 4/7/09); *Wright v. Medtronic Inc.*, No. 09-0443, 2010 WL 1027808, 49 EBC 1368 (D. Minn. Mar. 17, 2010) (52 PBD, 3/19/10; 37 BPR 634, 3/23/10); *Herrera v. Wyeth*, No. 08-4688, 2010 WL 1028163, 49 EBC 1835 (S.D.N.Y. Mar. 17, 2010) (73 PBD, 4/19/10; 37 BPR 932, 4/20/10); *Gearren v. McGraw-Hill Cos.*, 690 F. Supp. 2d 254, 48 EBC 2057 (S.D.N.Y. Feb. 10, 2010) (29 PBD, 2/16/10; 37 BPR 415, 2/23/10), *appeal docketed*, No. 10-792 (2d Cir. Mar. 4, 2010); *In re Lehman Bros. Sec. & ERISA Litig.*, 683 F. Supp. 2d 294, 48 EBC 1838 (S.D.N.Y. 2010) (22 PBD, 2/4/10; 37 BPR 320, 2/9/10), *appeal docketed*, No. 10-712 (2d Cir. Mar. 2, 2010); *In re Citigroup ERISA Litig.*, Case No. 07-9790, 2009 WL 2762708, 47 EBC 2025 (S.D.N.Y. Aug. 31, 2009) (167 PBD, 9/1/09; 36 BPR 2054, 9/8/09), *appeal docketed*, No. 09-3804 (2d Cir. Sept. 9, 2009); *Benitez v. Humana Inc.*, No. 08-0211, 2009 WL 3166651, 47 EBC 2441 (W.D. Ky. Sept. 30, 2009) (190 PBD, 10/5/09; 36 BPR 2299, 10/6/09); *In re Huntington Bancshares Inc. ERISA Litig.*, 620 F. Supp. 2d 842, 45 EBC 2773 (S.D. Ohio 2009) (26 PBD, 2/11/09; 36 BPR 359, 2/17/09), *appeal docketed*, No. 09-3251 (6th Cir. Mar. 10, 2010); *In re Harley-Davidson Inc. Sec. Litig.*, 660 F. Supp. 2d 953, 47 EBC 2618 (E.D. Wis. 2009) (195 PBD, 10/13/09; 36 BPR 2398, 10/20/09), *appeal docketed*, No. 10-1919 (7th Cir. Apr. 15, 2010); *Crocker v. KV Pharmaceutical Co.*, 2010 WL 1257671 at *19, 49 EBC 1459 (E.D. Mo. Mar. 24, 2010) (59 PBD, 3/30/10; 37 BPR 787, 4/6/10); *Morrison v. MoneyGram Int'l, Inc.*, 607 F. Supp. 2d 1033, 1051, 46 EBC 1673 (D. Minn. 2009) (57 PBD, 3/27/09; 36 BPR 774, 3/31/09); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-6297, 2008 WL 5234281, 45 EBC 1977 (W.D.N.Y. Dec. 12, 2008) (240 PBD, 12/16/08; 35 BPR 2925, 12/30/08); *Smith v. Delta Air Lines Inc.*, 422 F. Supp. 2d 1310, 37 EBC 1968 (N.D. Ga. 2006) (77 PBD, 4/21/06; 33 BPR 1043, 4/25/06); *In re Westar Energy Inc. ERISA Litig.*, No. 03-4032, 2005 WL 2403832, 36 EBC 2328 (D. Kan. Sept. 29, 2005) (193 PBD, 10/6/05; 32 BPR 2173, 10/11/05).

[23] *See, e.g., Rankin v. Rots*, 278 F. Supp. 2d 853, 879, 30 EBC 2761 (E.D. Mich. 2003) (162 PBD, 8/22/03; 30 BPR 1875, 8/26/03); *In re Enron Sec., Derivative & ERISA Litig.*, 284 F. Supp. 2d 511, 534, 31 EBC 2281 (S.D. Tex. 2003) (191 PBD, 10/3/03; 30 BPR 2200, 10/7/03); *In re AEP ERISA Litig.*, 327 F. Supp. 2d 812, 828, 33 EBC 2404 (S.D. Ohio 2004) (155 PBD, 8/12/04; 31 BPR 1796, 8/17/04); *In re Elec. Data Sys. Corp. ''ERISA'' Litig.*, 305 F. Supp. 2d 658, 670, 34 EBC 2373 (E.D. Tex. 2004) (218 PBD, 11/12/04; 31 BPR 2572, 11/16/04); *In re CMS Energy ERISA Litig.*, 312 F. Supp. 2d 898, 914 n. 10, 32 EBC 2613 (E.D. Mich. 2004) (80 PBD, 4/27/04; 31 BPR 988, 5/4/04).

[24] *See, e.g., In re Schering-Plough ERISA Litig.*, 420 F.3d 231, 238, 35 EBC 1801 (3d Cir. 2005) (161 PBD, 8/22/05; 32 BPR 1827, 8/23/05) (later distinguished by *Edgar v. Avaya Inc.*, 503 F.3d 340, 347, 41 EBC 2249 (3d Cir. 2007) (187 PBD, 9/27/07; 34 BPR 2365, 10/2/07)); *Lingis v. Motorola Inc.*, 649 F. Supp. 2d 861, 876, 47 EBC 1099 (N.D. Ill. 2009) (116 PBD, 6/19/09; 36 BPR 1506, 6/23/09); *DiFelice v. U.S. Airways Inc.*, 436 F. Supp 2d. 756, 787-88, 38 EBC 1072 (E.D. Va. 2006) (125 PBD, 6/29/06; 33 BPR 1581, 7/4/06); *In re Westar Energy Inc. ERISA Litig.*, No. 03-4032-JAR, 2005 WL 2403832, *19, 36 EBC 2328 (D. Kan. Sept. 29, 2005) (193 PBD, 10/6/05; 32 BPR 2173, 10/11/05); *In re Mut. Funds Inv. Litig.*, 403 F. Supp. 2d 434, 449, 36 EBC 1711 (D. Md. 2005) (235 PBD, 12/9/05; 32 BPR 2723, 12/13/05).

[25] *See, e.g., Wright*, 360 F.3d at 1098 n.3; *Edgar v. Avaya Inc.*, 503 F.3d 340, 347, 41 EBC 2249 (3d Cir. 2007) (187 PBD, 9/27/07; 34 BPR 2365, 10/2/07); *Kirschbaum v. Reliant Energy Inc.*, 526 F.3d 243, 254, 43 EBC 2281 (5th Cir. 2008) (82 PBD, 4/29/08; 35 BPR 1034, 5/6/08); *In re Wachovia Corp. ERISA Litig.*, No. 3:09-cv-262, 2010 WL 3081359, at *13 (W.D.N.C. Aug. 6, 2010) (152 PBD, 8/10/10; 37 BPR 1829, 8/17/10); *Wright v. Medtronic, Inc.*, No. 09-cv-0443, 2010 WL 1027808, at *5, 49 EBC 1368 (D. Minn. Mar. 17, 2010) (52 PBD, 3/19/10; 37 BPR 634, 3/23/10); *Morrison v. MoneyGram Int'l, Inc.*, 607 F. Supp. 2d 1033, 1051, 46 EBC 1673 (D. Minn. 2009) (57 PBD, 3/27/09; 36 BPR 774, 3/31/09); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-6297, 2008 WL 5234281, at *5, 45 EBC 1977 (W.D.N.Y. Dec. 12, 2008) (240 PBD, 12/16/08; 35 BPR 2925, 12/30/08); *In re RadioShack ERISA Litig.*, 547 F. Supp. 2d 606, 613, 43 EBC 2059 (N.D. Tex. 2008) (66 PBD, 4/7/08; 35 BPR 779, 4/8/08); *In re Calpine Corp. ERISA Litig.*, No. C-03-1685, 2005 WL 1431506, at *4-5, 35 EBC 1181 (N.D. Cal. Mar. 31, 2005) (79 PBD, 4/26/05; 32 BPR 1027, 5/3/05).

[26] *See, e.g., In re Ford Motor Co. ERISA Litig.*, 590 F. Supp. 2d 883, 892, 45 EBC 2057 (E.D. Mich. 2008) (246 PBD, 12/24/08; 35 BPR 2926, 12/30/08); *In re Goodyear Tire & Rubber Co. ERISA Litig.*, 438 F. Supp. 2d 783, 793, 38 EBC 1456 (N.D. Ohio 2006) (132 PBD, 7/12/06; 33 BPR 1686, 7/18/06); *In re Ferro Corp. ERISA Litig.*, 422 F. Supp. 2d 850, 860-61, 37 EBC 1651 (N.D. Ohio 2006) (57 PBD, 3/24/06; 33 BPR 809, 3/28/06).

[27] *See, e.g., Citigroup*, 2009 WL 2762708, at *18; *Fisher v. JPMorgan Chase & Co.*, No. 03 Civ. 3252 (SHS), 2010 WL 1257345, *8, 48 EBC 2583 (S.D.N.Y. Mar. 31, 2010) (62 PBD, 4/2/10; 37 BPR 786, 4/6/10); *In re Lehman Bros. Sec. & ERISA Litig.*, 683 F. Supp. 2d 294, 48 EBC 1838 (S.D.N.Y. 2010) (22 PBD, 2/4/10; 37 BPR 320, 2/9/10); *Gearren v. McGraw-Hill Cos.*, 690 F. Supp. 2d 254, 48 EBC 2057 (S.D.N.Y. 2010) (29 PBD, 2/16/10; 37 BPR 415, 2/23/10); *In re Avon Prods. Inc. ERISA Litig.*, No. 05-6803, 2009 WL 848083, at *10, 46 EBC 1769 (S.D.N.Y. Mar. 3, 2009) (41 PBD, 3/5/09; 36 BPR 569, 3/10/09) (magistrate recommendation), *adopted by district*

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perhaps in frustration, to observe that the *Moench* presumption ''can be rebutted by a showing of a constellation 'of one damned thing after another.' ''[28]

In short, there is little agreement on when or how the *Moench* presumption should be applied and this disagreement is the direct result, in the opinion of the authors, of the Third Circuit's misguided resort to legislative history and the common law of trusts rather than the plain language of the governing statutes. Indeed, in *Moench*, the Third Circuit seemed to almost be making it up as it went along, struggling to find a basis for treating employer securities differently seemingly everywhere but the statute itself.

When in Doubt, Look to the Statute

Section 404(a)(2) reflects congressional intent to free fiduciaries of eligible individual account plans from ERISA's diversification requirement, which mandates that a fiduciary diversify a plan's assets to the extent necessary to avoid the risk of large losses. Of course, the diversification requirement would *de facto* be violated by an ESOP which requires that its assets be primarily invested in a single (employer) security.[29] Significantly, Section 404(a)(2) goes on to relieve fiduciaries of the duty of prudence to the extent that it requires diversification, suggesting that there may be some lingering duty—prudence *sans* diversification—that still applies.[30]

But what does that mean as a practical matter? If a fiduciary of a plan that is invested 50 percent or more in employer securities is not required to consider diversification, a strategy for reducing ''company specific'' risk, what is left for the fiduciary to consider? Surprisingly few courts have addressed this question.

Modern portfolio theory dictates that risk associated with investment in a specific company—ultimately the risk that the company will go bankrupt or lose substantial value—is mitigated through diversification of the asset portfolio, i.e., investing in other stocks or bonds, not all of which will go bankrupt or lose value.[31] Freeing a fiduciary of the duty to mitigate this risk means that she or he is free to assume exclusively company specific, or unsystematic risk—the highest level of risk that can be assumed in the marketplace—without any obligation to mitigate that risk by investing in other assets. In other words, the fiduciary is free to accept the unmitigated risk that employer securities may lose most, or even all, of their value without regard to the possible effect on the plan's portfolio as a whole.

Translated into plain English, this means that a fiduciary disregards the degree of a plan's concentration in employer securities, effectively treating the plan's investment as if it were a single share rather than, as is often the case, millions of shares worth hundreds of millions or even billions of dollars. That was the conclusion of the district court in *Wright v. Medtronic Inc.*,[32] which struggled to fit its analysis into the *Moench* presumption construct:

> '[A]n abuse of discretion under *Moench* begins (and the presumption of prudence ends) at the point at which company stock becomes so risky that no prudent fiduciary, reasonably aware of the needs and risk tolerance of the plan's beneficiaries, would invest *any* plan assets in it, regardless of what other stocks were also in that plan's portfolio.'. . . In this case, then, plaintiffs' prudence claim can survive only if they have alleged sufficient facts to demonstrate that they have a non-speculative claim that investing in Medtronic stock during the class period was so risky that no prudent fiduciary would have invested *any* Plan assets in Medtronic stock.[33]

The question thus becomes, when would it be imprudent for that fiduciary to continue to hold (or buy) a single share of stock in a plan that typically holds millions (or billions) of dollars of other assets? ERISA's prudence standard requires that this question be answered by reference to a hypothetical prudent fiduciary managing an ''enterprise of a like character and with like aims.''[34]

A fiduciary of a large asset portfolio would not pay the same attention to a single share of stock held in that portfolio as it would to much larger holdings, subjecting the latter to rigorous ongoing monitoring and analysis. Indeed, the fiduciary would probably feel compelled to sell that single share only if the fiduciary had actual knowledge that it was about to become worthless. This

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court, 2009 WL 884687, 46 EBC 1786 (S.D.N.Y. Mar. 30, 2009) (60 PBD, 4/1/09; 36 BPR 860, 4/7/09); *In re Dell Inc. ERISA Litig.*, 563 F. Supp. 2d 681, 694, 45 EBC 1346 (W.D. Tex. 2008) (130 PBD, 7/8/08; 35 BPR 1668, 7/15/08); *In re Radioshack Corp. ERISA Litig.*, 547 F. Supp. 2d 606, 615-16, 43 EBC 2059 (N.D. Tex. 2008) (66 PBD, 4/7/08; 35 BPR 779, 4/8/08); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-6297, 2008 WL 5234281, at *6, 45 EBC 1977 (W.D.N.Y. Dec. 12, 2008) (240 PBD, 12/16/08; 35 BPR 2925, 12/30/08); *In re Coca-Cola Enterp. Inc. ERISA Litig.*, 2007 WL 1810211, at *10, 41 EBC 1523 (N.D. Ga. June 20, 2007) (122 PBD, 6/26/07; 34 BPR 1607, 7/3/07); *Smith v. Delta Air Lines Inc.*, 422 F. Supp. 2d 1310, 1331, 37 EBC 1968 (N.D. Ga. 2006) (77 PBD, 4/21/06; 33 BPR 1043, 4/25/06); *In re Duke Energy ERISA Litig.*, 281 F. Supp. 2d 786, 795, 30 EBC 2781 (W.D.N.C. 2003) (160 PBD, 8/20/03; 30 BPR 1876, 8/26/03).

[28] *In re Ford Motor Co. ERISA Litig.*, 590 F. Supp. 2d 883, 911-12, 45 EBC 2057 (E.D. Mich. 2008) (246 PBD, 12/24/08; 35 BPR 2926, 12/30/08).

[29] ERISA Section 407(d)(6)(A).

[30] Acquisition and sale of employer securities are generally exempt from ERISA's prohibited transaction rules but it is common for plaintiffs in stock-drop litigation to include allegations that fiduciaries breached their duty of loyalty under ERISA Section 404(a)(1)(A) by, for example, holding plan stock while selling their own stock, allegedly to keep the price artificially high. These allegations are typically fact intensive and are not addressed in this article.

[31] Edwin J. Elton, *et al.*, ''Modern Portfolio Theory and Investment Analysis,'' Ch. 4 (8th ed. 2010).

[32] 2010 WL 1027808, 49 EBC 1368 (D. Minn. Mar. 17, 2010) (52 PBD, 3/19/10; 37 BPR 634, 3/23/10).

[33] *Id.*, at 5-6, quoting *In re Ford Motor Co. ERISA Litig.*, 590 F. Supp. 2d 883, 893, 45 EBC 2057 (E.D. Mich. 2008) (246 PBD, 12/24/08; 35 BPR 2926, 12/30/08).

[34] ERISA Section 404(a)(1)(B). Some have suggested that another way to look at the standard of prudence is to consider the purpose of Section 404(a)(2), to foster and encourage employee ownership, and determine when a prudent fiduciary would abandon that goal. Arguably, that point would be reached when the fiduciary determines that continued ownership of employer securities no longer meets that goal. In other words, when the employer is likely to cease to exist (and the securities are likely to become worthless). *See e.g.*, *Steinman v. Hicks*, 352 F.3d 1101,1103, 31 EBC 2415 (7th Cir. 2003) (239 PBD, 12/16/03; 30 BPR 2752, 12/16/03) (discussing congressional intent to promote employee ownership).

is the same conclusion reached by several courts that have applied the *Moench* presumption.[35]

The difference, of course, is that this prudence standard is not based on vague notions of individual plan language or presumptions and subjective views of the relative strength of these presumptions at varying stages of litigation; it is based on the statutory mandate that eligible individual account plan fiduciaries be freed of the diversification requirement and the duty of prudence to the extent it requires diversification. In this crucial respect it allows far less latitude for divergent views and ensures more uniform adjudication of the hundreds of substantially identical stock-drop claims that have clogged the federal courts over the last decade.

Moreover, moving to a statutory standard of review of these claims would have the immediate effect of ending disagreement over whether the ''presumption'' applies only to ESOPs because ERISA Section 404(a)(2) exempts all eligible individual account plans that hold employer securities from the diversification requirement. Similarly, there would no longer be disagreement over whether the presumption is ''evidentiary'' and should be applied on a Rule 12 motion, since it is the statutory language that establishes the standard of pleading and proof, not a judicially created presumption.

Finally, the widely varied application of the presumption—in some courts easily overcome and in others overcome only if impending collapse is pled or proved—should come to an end, providing certainty for courts and litigants, and perhaps most importantly, plan sponsors who have begun to rethink the wisdom of offering tax code Section 401(k) plans in the wake of this uncertainty.

[35] *See* footnote 27, *supra.* Of course this leaves the question of when a fiduciary might acquire knowledge that an employer security is about to become worthless. As Judge Richard A. Posner noted, ''it would be *hubris* for a trust company like State Street to think it could predict United's future more accurately than the market could[.]'' *Summers v. State Street Bank & Trust Co.*, 453 F.3d 404, 408, 38 EBC 1065 (7th Cir. 2006) (125 PBD, 6/29/06; 33 BPR 1582, 7/4/06). If the knowledge is not public, the fiduciary would not be able to legally use it to the effective advantage of the plan. *See* footnote 19, *supra*. *See also, Edgar*, 503 F.3d at 350 (''had the . . . defendants 'publicly released any adverse information . . . 'such disclosure would have resulted in a swift market adjustment.' Therefore . . . the Plans would have sustained the same losses they incurred when the Company publicly announced the quarterly results in April 2005.'') (citation omitted).

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