No. 15-1199

IN THE

Supreme Court of the United States

RAYMOND PFEIL, MICHAEL KAMMER, ANDREW GENOVA, RICHARD WILMOT, JR. AND DONALD SECEN (ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED),

Petitioners,

v.

STATE STREET BANK AND TRUST COMPANY,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITIONERS' REPLY BRIEF

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STATEMENT

Respondent concedes that this Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014), represents an "important change in case law" (BIO at 12) and that the Sixth Circuit's opinion provides guidance for the district courts interpreting it. *Id.* As demonstrated in the Petition, however, the Sixth Circuit, and other lower courts, have badly misinterpreted *Dudenhoeffer* as affording per se immunity to ESOP fiduciaries whenever the stock trades in an efficient market, no matter how dangerous, risky or speculative the investment. This interpretation of *Dudenhoeffer* is not supported by the language of this Court's opinion, ERISA's statutory text, or the implementing regulations promulgated by the Department of Labor ("DOL"). It is also contrary to longstanding practice in the industry, which has long recognized that even company stock traded on the largest and most efficient public exchange can be, under facts and circumstances similar to those that existed in this case, an objectively imprudent investment for an ESOP.

The Petition should be granted to afford this Court the opportunity, in the context of a fully developed summary judgment record rather than a barebones pleading motion, to correct the lower courts' erroneous interpretation of *Dudenhoeffer*. The Sixth Circuit read this Court's decision as stripping the ability of the tens of millions of U.S. employees — who have invested their retirement savings in ESOPs holding publicly traded company stock, including the GM workers in this case — to bring claims in appropriate circumstances against ESOP fiduciaries for breach of the duty of prudence.

Dudenhoeffer did not mean (and could not have meant) what the Sixth Circuit said, and Judge White's dissent in this case recognized the substantial ramifications of the decision below. She criticized the panel majority for adopting a rule "that effectively immunizes fiduciaries from imprudence claims relating to publicly traded securities in the absence of special circumstances." Pet. App. 89a.

If left unreviewed, the misinterpretation of *Dudenhoeffer* by the decision below will have grave consequences for the retirement savings of vast numbers of workers – consequences that this Court never intended. At a minimum, this Court should request the views of the United States on this important question.

REASONS FOR GRANTING THE PETITION

I. REVIEW IS WARRANTED TO CORRECT THE LOWER COURTS' CLEAR MISINTERPRETATION OF *DUDENHOEFFER*

The Sixth Circuit's decision, and the other decisions interpreting *Dudenhoeffer* cited in the BIO, hold incongruously that this Court replaced the presumption of prudence, which the Court rejected because it is not contained in ERISA, with another Court-created rule without support in the statutory text – *i.e.*, that an ESOP fiduciary's decision to invest in company stock is *per se* prudent any time the stock trades in an "efficient market," absent the showing of special circumstances to defeat the efficient market presumption. "Such a conclusion would apparently mean that the only remaining duty of such a fiduciary [is] to ensure that nothing is impeding market mechanisms from accurately pricing the stock [and] . . . would, in one fell swoop, demote the ERISA duty of prudence from being 'the highest known to law,' . . . to being largely illusory." *In re Ford Motor Co. ERISA Litig.*, 590 F. Supp. 2d 883, 891 (E.D. Mich. 2008) (quoting *Chao v. Hall Holding Co.*, 285 F.3d 415, 426 (6th Cir. 2002)).

In fact, however, Congress has declined to create such a "tidy limiting principle." *Ford*, 590 F. Supp. 2d at 892. The statutory standard is "prudence," 29 U.S.C. §1104(a)(1)(b), and as the DOL recognized in connection with an earlier appeal in this case, this statutory obligation requires an ESOP fiduciary "to evaluate the riskiness of [company] stock" held in the ESOP, not to assess whether the stock trades in an efficient market. *See* Case No. 10-2302, Amicus Brf. at 19 (6th Cir. Feb. 15, 2011) ("As independent fiduciary and investment manager, State Street's job was to evaluate the riskiness of GM stock."); *see also Ford*, 590 F. Supp. 2d at 891 (quoting 29 C.F.R. §2550.404a-1(b)) ("[T]he regulations implementing ERISA . . . provide that to satisfy the statutory duties a fiduciary must, among other things, 'tak[e] into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action.'"). In her dissent, which the BIO ignores except in passing, Judge White explained the disconnect between the Sixth Circuit's focus on market efficiency to the exclusion of the risk profile of company stock and risk tolerance of ESOP beneficiaries in assessing Plaintiffs' claim that continued investment in GM stock was imprudent under ERISA stating: "One can concede that the market is generally efficient in pricing stocks without concluding that all decisions to buy, sell or hold are therefore prudent." Pet. App. 90a.

Respondent's arguments to the contrary notwithstanding, *Dudenhoeffer* did not replace the statutory duty of prudence with a duty to monitor market efficiency. *Dudenhoeffer* established *a pleading standard* for claims of breach of the duty of prudence in a case in which plaintiffs alleged, at least in part, that the ESOP fiduciary should have known, solely on the basis of publicly available information, that the company's stock price was artificially inflated and, therefore, was an imprudent investment. While market efficiency may be an appropriate means of "readily divid[ing] the plausible sheep from the meritless goats," *Dudenhoeffer*, 134 S. Ct. at 2470, in the context of a case like *Dudenhoeffer*, it makes no sense as a mechanism for weeding out meritless claims in a case such as this one where Plaintiffs' claim is not that the market for GM stock was inefficient or that GM's stock price was artificially inflated, but rather that GM stock, based on its objective characteristics, had become too risky an investment to be offered as an investment option to GM's workers. Respondent's assertion that *Dudenhoeffer* applied the same rule to the *Dudenhoeffer* plaintiffs' "risk-based claims" ignores that the plaintiffs' claim in *Dudenhoeffer* was that Fifth Third stock was "*overvalued and excessively risky*," *id.* at 2464 (emphasis added), and that the plausibility standard announced by the Court concerned allegations "that a fiduciary should have recognized from publicly available information alone that the market *was over- or undervaluing the stock*." *Dudenhoeffer*, 134 S. Ct. at 2471 (emphasis added). Indeed, the Sixth Circuit appeared to recognize that a claim that the market was over- or undervaluing the stock was required to apply the *Dudenhoeffer* rule when it mischaracterized Plaintiffs' claim as follows: "Pfeil alleges that, in response only to various *public announcements* about GM's future, State Street's investment strategy failed to function as a prudent process if it did not recognize 'that the market was over- or undervaluing' GM common stock.'" Pet. App. 84a (quoting *Dudenhoeffer*, 134 S. Ct. at 2471) (emphasis in original).

Respondent's argument that "'overvalued' versus 'too risky' is a semantic distinction without a difference, because the stock price in an efficient market *incorporates* the risk of holding the stock" (BIO at 15 (emphasis in original)) is a *non sequitur*. As Judge White explained in her dissent, "the fact that a stock's price accurately reflects the company's risk of failing does not mean that it is prudent to retain the stock as that possibility becomes more and more certain and buyers are willing to pay less and less for a stake in the upside potential." Pet. App. 90a. While the majority dismisses Judge White's cogent observation as an "evil[] . . . endemic to the ESOP form established by Congress" (Pet. App. 86a), in *Dudenhoeffer*, this Court made clear that, save for the duty to diversify, "the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries." *Dudenhoeffer*, 134 S. Ct. at 2467. For this reason, countless courts have held that imprudence on the part of an ESOP fiduciary has been plausibly alleged where the fiduciary continued to hold stock in a collapsing company because the catastrophic risk that retirees' savings will be lost outstripped whatever *de minimis* upside potential existed from continuing to hold the stock. *See Quan v. Computer Sciences Corp.*, 623 F.3d 870, 882 (9th

Cir. 2010) ("allegations that 'clearly implicate[ ] the company's viability as an ongoing concern' or show 'a precipitous decline in the employer's stock ... combined with evidence that the company is on the brink of collapse or is undergoing serious mismanagement'" sufficient to allege company stock was an imprudent investment); *Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 255 (5th Cir. 2008) (evidence that company's "viability as a going concern was ... threatened" or that the company's stock "was in danger of becoming essentially worthless" necessary to allege company stock was an imprudent investment).

Indeed, it has long been recognized by ESOP fiduciaries, including Respondent, that a company stock trading in an efficient market nevertheless can be an imprudent investment for an ESOP. For example, in *Bunch v. W.R. Grace & Co.*, 555 F.3d 1 (1st Cir. 2009), although there was no dispute that W.R. Grace stock traded in an efficient market, State Street concluded that it was an imprudent investment for the ESOP and sold it "because of the risks inherent to the price of the stock" as a result of potential liability from asbestos litigation, and because it found that "'the market price of W.R. Grace stock [was] not a good indication of its long term value.'" *Id.* at 5. In defending its decision in litigation brought by beneficiaries of the ESOP who contended "that the efficient market was the standard by which the court should measure State Street's actions," State Street correctly asserted that "the current market price of Grace stock constituted only one of the factors that a prudent fiduciary under ERISA needed to consider in deciding whether to retain or divest the stock" from the ESOP. *Id.* at 6.

Contrary to Respondent's contention (BIO at 16), Plaintiffs' claim that GM stock had become too risky an investment does not "assume liability is proven by a declining stock price." Nor did Plaintiffs, contrary to the Sixth Circuit's assertion (Pet App. 85a), invite the court to second guess Respondent's decision based on hindsight. The summary judgment record in this case is replete with facts that were available to Respondent at the time it determined not to divest, demonstrating that irrespective of its then-current stock price, the GM stock held in the ESOP was going to be "pretty much worthless" even in the event GM received government assistance. (R.92-1, Plaintiffs' Rule 56 Statement of Undisputed Facts; ¶¶52-56). Because it was exclusively focused on market efficiency, however, the Sixth Circuit ignored all of this evidence.

II. THE SIXTH CIRCUIT'S HOLDING THAT STATE STREET'S PURPORTEDLY PRUDENT PROCESS ALONE SATISFIED ITS DUTY OF PRUDENCE CONFLICTS WITH THIS COURT'S DECISION IN *TIBBLE*

As explained in the Petition (Pet. at 20-21), it has long been recognized, including by this Court in *Tibble v. Edison Intern.*, 135 S. Ct. 1823 (2015), that an ERISA fiduciary's duty of prudence includes the duty to remove imprudent investments. The Sixth Circuit's holding that Respondent's purportedly prudent process alone satisfied its duty of prudence (Pet. App. 88a) is inconsistent with this long line of authority.

In its BIO, Respondent does not appear to contest that *Tibble* recognized an ERISA fiduciary's duty to monitor and remove imprudent investments. Nor could it. In *Tibble*, this Court plainly held that "[a] plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones." *Id.* at 1829.

Respondent's suggestion that the Fourth Circuit's decision in *Tatum v. RJR Pension Investment Committee*, 761 F.3d 346 (4th Cir. 2014) demonstrates that there is no duty to remove imprudent investments post *Dudenhoeffer* badly mischaracterizes the decision in *Tatum*. Contrary to Respondent's contention, *Tatum* did not hold that "[i]f a fiduciary acts with procedural prudence ... then ERISA's duty of prudence is satisfied." BIO at 23. Instead, the court in *Tatum* instructed that the fiduciary's decision must also be "objectively prudent." *Tatum*, 761 F.3d at 361.

Here, the Sixth Circuit ignored the voluminous record evidence demonstrating that, at a minimum, a genuine issue of material fact existed with respect to whether GM stock remained an objectively prudent investment to hold in the ESOP. As Judge White observed in her dissent, to the extent the majority simply relied on the actions of other fiduciaries who continued to buy and hold GM stock as definitive evidence that GM stock remained an objectively prudent investment for the ESOP, the summary judgment record did not establish that these decisions were made in a similar context as *Dudenhoeffer* requires and, therefore, "[t]here [was] at least a question of fact whether State Street satisfied its duty of prudence under the circumstances." Pet. App. 92a (quoting *Dudenhoeffer*, 134 S. Ct. at 2471 ("[T]he Supreme Court explained in *Dudenhoeffer* that 'the appropriate inquiry will necessarily be context specific.'")).

The majority's holding that Respondent's process was prudent because "State Street discussed GM stock scores of times during the class period" is equally flawed. Pet. App. 87a. Here, too, the majority simply ignored inconvenient record evidence as, for example, when it cited the opinions of Respondent's experts that "State Street's process for monitoring GM (and other) stock was prudent" (Pet. App. 88a), while ignoring the contrary opinion of Plaintiffs' expert. (R.98-4, Biller Report; Exhibit to R.93, Clark-Weintraub Declaration). In fact, voluminous evidence in the summary judgment record demonstrated a grossly imprudent process including, but not limited to, the evidence cited in Judge White's dissent indicating "that the decision makers were operating under an incorrect standard." Pet. App. 90a. As Judge White explained, "[a] necessary part of a prudent decision-making process is the yardstick applied to the information yielded by prudent investigation and consideration." *Id.* The majority also made no mention of State Street's stunning about-face on December 12, 2008, when State Street's Fiduciary Committee found at 9:00 a.m. that a GM bankruptcy was "imminent," concluded that continuing to hold GM stock was "not consistent with ERISA," and voted to begin selling GM stock, only to reverse itself a mere 90 minutes later based on nothing more than a statement from the White House that it was "considering," but had not committed to, using funds from the TARP program as a stop-gap measure to temporarily keep GM out of bankruptcy. Pet. at 5-6.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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