WHAT'S UP ON STOCK-DROPS? *MOENCH* REVISITED

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I. INTRODUCTION

In the wake of the corporate scandals and stock market decline beginning in 2000 and 2001, an increasing number of lawsuits were filed against publicly traded companies whose stock prices dropped in value. Although securities violations were initially the most common basis for these claims, plaintiffs also began to raise claims for breach of fiduciary duty under the Employee Retirement Income Security Act of 1974, as amended, ("ERISA") against the fiduciaries of the companies' defined contribution retirement plans that held employer stock. In these ERISA "stock drop cases," courts are forced to reconcile competing considerations in ERISA law: while ERISA encourages employee ownership through defined contribution plan ownership of employer stock, it also imposes a "prudence" requirement with respect to the acquisition or holding of that employer stock. Thus, although ERISA permits, even encourages, fiduciaries to invest up to 100% of plan assets in employer stock, plaintiffs in stock drop cases suggest that the fiduciary duty of prudence requires fiduciaries to divest employer stock under certain circumstances. Attempting to reconcile these competing concerns has not been an

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easy task for the fiduciaries, lawyers, and judges involved in the many ERISA stock drop cases filed in the past five years.

This article addresses the confusion regarding fiduciary duties engendered by ERISA stock-drop litigation, focusing on the controversy surrounding the so-called "*Moench* presumption," a judicial presumption first applied in the Third Circuit's 1995 opinion in *Moench v. Robertson*.[1] Generally, the *Moench* presumption provides that an ERISA fiduciary is entitled to a rebuttable presumption that its investment in employer stock is prudent under ERISA. In recent years, the First, Third, and Ninth Circuit Courts of Appeals have applied the *Moench* presumption in different ways, creating confusion over its application. Further, the Third[2] and Ninth Circuits[3] have split on whether the presumption applies to all defined contribution plans eligible to hold up to 100% employer stock or just to "Employee Stock Ownership Plans" (ESOPs), as was the case in *Moench*. ERISA refers to defined contribution plans eligible to hold up to 100% employer stock as "Eligible Individual Account Plans," (EIAPs). This article takes an in-depth look at the *Moench* opinion itself as well as the Third Circuit's subsequent opinion in *In re Schering-Plough Corp. ERISA Litigation*. Part II of this article provides a brief overview of fiduciary duties under ERISA, as well as the specific rules that apply to EIAPs and ESOPs. Part III examines the conceptual basis of the *Moench* and *Schering-Plough* decisions, and Part IV considers whether the logic of *Moench* can be generally applied to EIAPs, whether *Moench* and *Schering-Plough* are consistent with ERISA's statutory provisions, and whether *Moench* may encourage EIAP fiduciaries to violate security laws.

II. FIDUCIARY DUTIES UNDER ERISA: EIAPS AND ESOPS

ERISA governs most benefit plans offered by employers. Because of the importance of retirement plans, ERISA imposes rigorous obligations on people responsible for administering such plans. Among other things, ERISA fiduciaries have a duty of loyalty and a duty of prudence that requires them to act solely in the interest of the plan participants, to make independent and objective investment decisions for the benefit of the plan, and to avoid conflicts of interest that could undermine their loyalty to the interests of the plan. To this end, ERISA generally requires that fiduciaries diversify the plan's investments by investing no more than ten percent of the plan's assets in employer stock. To further avoid conflicts of interest or self-dealing, ERISA also prohibits any

1. 62 F.3d 553 (3d Cir. 1995).
2. In re Schering-Plough Corp. ERISA Litig., 420 F.3d 231 (3d Cir. 2005).
3. Wright v. Or. Metallurgical Corp., 360 F.3d 1090 (9th Cir. 2004).

transactions between the plan and the employer, shareholders, or other "parties in interest."

A. The Statutory Structure

An employee benefit plan is "simply a trust."[4] A "fiduciary" under ERISA is a liberal concept, which applies to those who exercise discretionary authority with respect to the plan. Under ERISA:

> [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such terms include any person designated [as a fiduciary] under section 405(c)(1)(B) [29 U.S.C. § 1105 (c)(1)(B)].[5]

Although the structure of a plan may designate a fiduciary, fiduciary status is not determined by formal designations alone. It is determined by the substantive authority that a person exercises vis-à-vis the plan.[6] Moreover, fiduciary status "is not an all or nothing concept."[7] Just as a person may be a fiduciary by virtue of the substantive authority he or she exercises over the plan, "a party is a fiduciary only as to the activities which bring the person within the definition [of a fiduciary]."[8] As such, depending on their function with respect to the plan, the company sponsoring the plan, officers, directors, directed trustees, or benefits and finance committee members may be considered fiduciaries under ERISA.[9]

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4. *Moench*, 62 F.3d at 571. See *also* S. REP. NO. 93-127, at 29 (1973) *as reprinted in* 1974 U.S.C.C.A.N. 4639, 4838, 4865 ("The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts."); Donovan v. Cunningham, 716 F.2d 1455, 1464 (5th Cir. 1983) ("The legislative history of ERISA indicates that Congress intended to incorporate in 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.").

5. 29 U.S.C. § 1002(21)(A) (2000).

6. *See* Craig C. Martin & Elizabeth L. Fine, ***ERISA Stock Drop Cases: An Evolving Standard,*** 38 J. MARSHALL L. REV. 889, 897-98 (2005) (noting that "[f]iduciary status under ERISA is to be construed liberally, consistent with ERISA's policies and objectives.") (quoting In re Elec. Data Sys. Corp. "ERISA" Litig., 305 F. Supp. 2d 658, 665 (E.D. Tex. 2004)).

7. Maniace v. Commerce Bank of Kan. City, N.A., 40 F.3d 264, 267 (8th Cir. 1994) (quoting Kerns v. Benefit Trust Life Ins. Co., 992 F.2d 214, 217 (8th Cir. 1993)).

8. Custer v. Sweeney, 89 F.3d 1156, 1162 (4th Cir. 1996).

9. *See*, *e.g.*, Dana M. Muir & Cindy A. Schipani, *New Standards of*

The fiduciaries of an employee benefit plan are charged with a number of affirmative obligations to the plan's beneficiaries. Under Section 404 of ERISA, there are four general duties imposed upon ERISA fiduciaries.[10] First, ERISA fiduciaries are required to discharge their duties in accordance with the terms of the plan, unless the terms of the plan are inconsistent or conflict with Titles I or IV of ERISA.[11] Second, ERISA fiduciaries have a duty of loyalty to the plan participants. ERISA fiduciaries must discharge their duties "solely in the interest of the participants and beneficiaries and (A) for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries. . ."[12] This duty encompasses situations where conflicts of interest or the risk of self-dealing arise, most often in cases where a fiduciary uses plan assets in a manner that does not place the beneficiaries' interest above all other interests.[13] The paradigmatic example of fiduciary breach of the duty of loyalty is where the interests of the employer and the beneficiaries of the plan are at odds, and the fiduciary - having responsibilities with respect to both entities - acts in a manner that places the employer's interest above the beneficiaries.

Third, ERISA fiduciaries have a duty of prudence, which has also been referred to as a duty of care.[14] ERISA fiduciaries must discharge their responsibilities "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."[15] The general duty of prudence concerns the manner in which ERISA fiduciaries make decisions regarding plan assets. It is a stringent duty, requiring the fiduciary to fully investigate the terms and risks of an investment, the qualifications of the investment advisors, and all other facts that a prudent fiduciary would deem relevant to a particular investment.[16] When combined with the duty of loyalty, the high

Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others?, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 279, 315, 319-22 (2005).

10. *See* 29 U.S.C. § 1104 (2000) (outlining the various duties of ERISA fiduciaries). *See also* Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1093-94 (9th Cir. 2004).

11. 29 U.S.C. § 1107(a)(3)(A).

12. 29 U.S.C. § 1104(a)(1).

13. *See* Martin v. Feilen, 965 F.2d 660, 670-71 (8th Cir. 1992) (stating that "the potential for disloyal self-dealing and the risk to the beneficiaries from undiversified investing are inherently great").

14. *Compare Wright*, 360 F.3d at 1101 (referring to the duty as a "duty of prudence") *with Moench v. Robertson*, 62 F.3d 553, 569 (3d Cir. 1995) (referring to the duty as a duty "of care").

15. 29 U.S.C. § 1104(a)(1)(B).

16. *See* Investment Duties, 29 C.F.R. § 2550.404a-1(b)(1)(i) (2005) (providing examples of fiduciary investment situations and duties involved with each); Meyer v. Berkshire Life Ins. Co., 250 F. Supp. 2d 544, 564 (D. Md.

level of responsibility imposed by ERISA on fiduciaries becomes clearer: ERISA fiduciaries have "an unwavering duty . . . to make decisions with single-minded devotion to a plan's participants and beneficiaries and, in so doing, to act as a prudent person would act in a similar situation."[17]

Beyond the general duties of prudence and loyalty, section 404 of ERISA also requires fiduciaries to diversify the investments of the plan "so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. . ."[18] Although this diversification requirement appears in a separate section of ERISA and is not specifically addressed in the ERISA sections dealing with the duty of loyalty and prudence, the diversification requirement is more appropriately viewed as an outgrowth of the duty of prudence. In other words, because large losses to the plan are easier to avoid if the investments of the plan are diversified, prudence in investment would normally dictate that a fiduciary diversify the assets of the plan. The fact that ERISA utilizes a separate section to outline the requirement that investments be diversified reflects a judgment on the part of Congress that diversified investments are prudent investments. Nevertheless, ERISA excuses a fiduciary's failure to diversify if the fiduciary can demonstrate that it was clearly prudent to not do so. As discussed in part II.C. of this article, the diversification requirement does not apply to the acquisition or holding of employer stock by an EIAP.

Supplementing these duties, ERISA imposes a number of requirements upon ERISA fiduciaries to avoid self-dealing, conflicts of interests, and keep the interests of the plan separate and distinct from the potentially independent interests of the employer.[19] For example, an employer's securities ordinarily may

2003) (stating that the duty of prudence requires fiduciaries to: "(1)employ proper methods to investigate, evaluate and structure the investment; (2) act in a manner as would others who have a capacity and familiarity with such matters; and (3) exercise independent judgment when making investment decisions."). The Department of Labor has taken the position that a fiduciary acts as a "prudent man" with respect to investment duties if the fiduciary:

> [h]as given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and . . . [h]as acted accordingly.

29 C.F.R. § 2550.404a-1(b)(1) (2005).

17. Morse v. Stanley, 732 F.2d 1139, 1145 (2d Cir. 1984).

18. 29 U.S.C. § 1104(a)(1)(C).

19. *See generally* 29 U.S.C. §§ 1106, 1107 (outlining additional fiduciary duties); Donovan v. Cunningham, 716 F.2d 1455, 1464-65 (5th Cir. 1983) ("These prohibited transaction rules are an important part of Congress's effort

not comprise more than ten percent of the fair market value of a plan's total investments.[20] Similarly, ERISA prohibits a fiduciary from engaging in a transaction that involves both the plan and a "party in interest" - namely, the employer, plan fiduciaries, or other related parties.[21] ERISA also makes fiduciaries personally liable for the breach of their various duties and requirements.

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary.[22]

Thus, ERISA fiduciaries are particularly susceptible to lawsuits based on an expansive range of breach of fiduciary duty claims. Indeed, not only are their combined duties under ERISA expansive, but they may be held personally liable for their failure to fulfill these numerous duties.

B. Pension Plans Generally

A pension plan is essentially a savings program undertaken during the worker's employment, followed by a distribution of the collected savings to the worker after his or her retirement. Although pension plans are of an "infinite variety,"[23] they can generally be divided into two categories: defined benefit plans and defined contribution plans. ERISA governs both types of plans.

The more traditional form of pension plans is the defined benefit plan. A defined benefit plan pays fixed and determinable benefits after an employee's retirement. The amount is fixed because the employer or plan sponsor makes a promise to pay the retirement pension in monthly or annual installments "according to a formula that adjusts benefits based on such variables as the employee's length of service and final salary."[24] Defined benefit plans accumulate assets for retirement benefits from two sources.

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to tailor traditional judge-made trust law to fit the activities of fiduciaries functioning in the special context of employee benefit plans. The object of Section 406 was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse.").

20. 29 U.S.C. § 1107(a)(3)(A).

21. 29 U.S.C. § 1106(a)(1)(A).

22. 29 U.S.C. § 1109(a).

23. *See* Employee Benefit Plans; Interpretation of Statute, 45 Fed. Reg. 8961 (Feb. 11, 1980) (codified at 17 C.F.R. pt 281) (displaying a list of possible pension plan types).

24. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule,* 55 U. CHI. L.REV. 1105, 1112 (1988).

They accumulate assets through contributions from the employer (and sometimes the employee) to the plan, as well as through investment of the plan's assets for profits.[25] However, because a defined benefit plan involves a promise of fixed benefits to the employee, the employer is obligated to meet the plan's expectations. If the investment results of the plan do not meet expectations, the employer will likely be required to make additional contributions to fund the promised benefits.[26] Defined benefit plans thus involve little risk from an employee's perspective - the employer bears the full burden of investment risk, while remaining obligated to pay the benefits to its employees in any event.[27]

Defined contribution plans, on the other hand, do not generally pay any fixed or determinable benefits. Often called individual account plans, defined contribution plans set up individual accounts for each participant in the plan. The earnings of the individual account constitute all of the benefits an employee is entitled to upon retirement, and the employer must contribute to each account at a rate specified in the plan. Unlike defined benefit plans, however, the earnings of the employee's individual account in defined contribution plans are not guaranteed by the employer. Instead, the employee's benefits vary depending upon the amount of plan contributions, the success in investing the plan's assets, and the allocations of forfeited benefits by non-vested participants who terminate employment.[28] The size of an employee's account, then, cannot be predetermined because it is based at least in part on the success of the plan's investments. Due to the increased risk undertaken by employees in defined contribution plans - receiving no promise of fixed and determinable benefits by the employer - the employee's individual account reaps the benefits of successful investments. Accordingly, the individual account also bears the burden of unsuccessful investments.[29]

25. Keir N. Dougall, Comment, *Augmenting ERISA With Market Discipline: Transforming Pension Plan Interests Into Securities,* 24 U. MICH. J.L. REF. 709, 716 (1991).

26. *See* Fischel & Langbein, *supra* note 24, at 1112-13 (stating the additional amount that the employer must contribute is usually based upon actuarial computations).

27. *See id.* at 1113 ("Since the employer has promised to provide benefits at a certain level, the employer remains liable to pay the benefits even if the fund turns up short. By the same token, when investments yield unexpectedly high returns, the employer's liability to contribute to the plan is correspondingly reduced.").

28. *Id*. at 1112.

29. *Id*. at 1112-13 ("Defined contribution and defined benefit plans allocate investment risk oppositely. Under a defined contribution plan, the employee bears the burden of disappointing investment results and pockets the gains from good results.").

C. Defined Contribution Plans

Under ERISA, both defined contribution plans and defined benefit plans may invest in employer securities. However, under § 407 of ERISA, defined benefit plans are subject to a ten percent cap on investments in employer securities.[30] On the other hand, defined contribution plans that qualify as EIAPs are subject to no such cap.[31] ERISA defines an EIAP as an "individual account plan, which is a profit-sharing, stock bonus, thrift or savings plan, [or] an employee stock ownership plan."[32] To be eligible as an EIAP under § 407(d)(3) - and thus be eligible to exceed the ten percent cap on investments in employer securities - the plan must follow certain guidelines. In order for a profit sharing plan, stock bonus plan, thrift or saving plan, or employee stock ownership plan to be considered an EIAP, the plan must specifically provide for investments in employer securities.[33] Moreover, an EIAP may not purchase or hold employer securities, which are not "qualified employer securities."[34]

Once a plan or portion of a plan is designated as an EIAP, three exemptions from ERISA's general rules regarding ERISA pension plans are triggered. The first exemption is from the ten percent cap on investments in employer securities. Second, as a corollary to the ten percent cap exemption, EIAPs are also exempted from one of ERISA's most important and fundamental prohibited transactions: the prohibition against any sale or exchange between the plan and a party in interest.[35] Section 408 of ERISA exempts EIAPs from this prohibition, thus allowing the EIAP to purchase employer securities from the employer, shareholders, or other related parties.[36]

Lastly, pursuant to ERISA section 404(a)(2) the fiduciary of the EIAP receives a complete exemption from the duty of asset diversification imposed under § 404(a)(1) of ERISA. Consistent

30. The employer securities must be "qualified" under ERISA. "Qualifying employer securities" under ERISA include (1) Any common or preferred stock; and (2) A debt security if it is part of an issue of which the plan owns no more than 25 percent and of which more than 50 percent is held by persons unrelated to the plan or the plan sponsor. 29 U.S.C. §§ 1107(d)(5), 1107(e).

31. *See id*. at § 1107 (d)(3)(A)(detailing an exception to any cap on investment in employer securities).

32. *Id*. at § 1107(d)(3)(A).

33. 29 U.S.C. §1107(b)(2)(B); *see also* William T. Knox, *Introduction to Qualified Retirement Plans That Invest In Employer Securities* 242 PLI/TAX 571, 575 (1986) (providing an in-depth look at ERISA's detailed requirements).

34. 29 U.S.C. § 1107(d)(3); *see supra* note 30 (defining "qualifying employer securities").

35. 29 U.S.C. §1108(e)(2000).

36. *See* §§ 4975(c)(1)(A); I.R.C. (d)(13). An EIAP may engage in a purchase or sale of qualifying employer securities only if the plan pays or receives "adequate consideration" in the exchange, and no commission was paid to any party with respect to the purchase or sale. 29 U.S.C. § 1108(e) .

with the law of trusts, § 404(a)(1) requires plan fiduciaries to diversify the plan's investments unless it would not be prudent to do so. Because EIAPs invest in employer securities, however, § 404(a)(2) also exempts ERISA EIAPfiduciaries from the duty to diversify the plan's investments.

D. The Special Privilege of ESOPs

An ESOP is a type of EIAP.[37] "The term 'employee stock ownership plan' did not appear in federal law prior to ERISA."[38] ESOPs were introduced into ERISA as both a means to employee ownership and as a technique of corporate finance.[39] Because an ESOP is a type of EIAP, it enjoys the three exemptions ERISA grants to EIAPs. Namely, ESOPs are not restricted by the ten percent cap on employer securities, may purchase employer securities from shareholders and employers, and the ESOP trustee is exempted from the fiduciary duty to diversify investments. However, ESOPs are distinguishable from EIAPs in at least four ways.

First, § 406(a)(1)(B) of ERISA and IRC § 4975(C)(1)(B) prohibit any lending or extension of credit between a plan and a party in interest. Although EIAPs are generally exempt from this prohibition as it applies to the purchase or sale of qualifying employer securities, EIAPs are not allowed to receive an extension of credit or loan from a party in interest. ESOPs, however, are exempted from the prohibition against loans or extensions of credit by and between a plan and a party in interest.[40] Unlike an EIAP, an ESOP may borrow funds from a party in interest to invest in company stock. Second, although an EIAP may invest in employer securities above the usual ten percent cap, it is not required to invest any particular amount above the ten percent cap. For ESOPs, on the other hand, the plan document must state that it will invest *primarily* in qualifying employer securities, which has been interpreted by the Internal Revenue Service to mean an investment in company stock of more than 50% over the life of the

37. An ESOP is a stock bonus plan or a combined stock bonus and money purchase plan that provides employees stock ownership in the employer corporation or other related corporations. 29 U.S.C. § 1107(d)(6)(A).

38. Knox, *supra* note 33, at 575.

39. *See* 129 CONG. REC. S16629, S16636 (daily ed. Nov. 7, 1983) (statement of Sen. Long) (stating that an ESOP would be both 'a technique of corporate finance' and an employee benefit plan"); *see also* Senate Finance Committee's Tax Reform Bill, SFC 3838.

40. 29 U.S.C. § 1108 (b)(3); 26 U.S.C. §4975(d)(3). *See* also Knox, *supra* note 33, at 578-79 (explaining that if an ESOP engages in an extension or loan of credit with the employer or an independent lending agency, the transaction is subject to a number of rules and providing a thorough sampling of the statutory governance of these extensions or loans).

plan.[41] Third, for EIAPs, IRC § 404(a)(3) limits deductions for contributions made by an employer to profit-sharing and stock bonus plans.[42] IRC § 404(a)(7) limits deductions to combinations of pension and profit-sharing or stock bonus plans.[43] IRC § 415(c) also generally limits the annual allocation to the participants' account under all defined contribution plans maintained by one or more related employer.[44] Under IRC § 415(c)(6), however, contributions to a leveraged ESOP to service debt incurred to purchase employer stock are exempted from these limits.[45] Finally, IRC § 404(k) allows an employer deduction for dividends paid to an employer stock held in an ESOP.

The combination of these ESOP exemptions creates significant operational differences between an ESOP and an EIAP. For example, employers may undertake what is referred to as a "leveraged ESOP." A leveraged ESOP is the technique of corporate finance contemplated by ERISA. In one scenario, the ESOP borrows money from an outside lender on the strength of an employer's guaranty, which is otherwise a prohibited extension of credit by the employer to the plan.[46] With the money loaned to the ESOP by the outside lender, the ESOP purchases stock from the employer or major shareholders.[47] As a result of the ESOP's purchase of employer stock, the employer is able to utilize the loaned money given to it by the ESOP. Over time, the employer makes periodic contributions to the ESOP, and those periodic contributions are used to pay off the loan to the ESOP from the outside lender. A second scenario involves lenders who would rather not lend money directly to the ESOP, instead preferring the security of making the loan directly to the employer. In this scenario, the employer borrows money from an outside lender, then lends the money it received from the outside lender to the ESOP. The ESOP uses the funds it borrowed from the employer to purchase employer stock, and the employer makes periodic contributions to the ESOP. With the employer's periodic

41. Treas. Reg. § 54.4975-11(b)(2004). *See also* D.O.L. Op. No. 83-6 A (Jan. 24, 1983) (stating that investment in employer securities must comprise "more than 50% of its assets" which will be measured "over the life of the plan").

42. 26 U.S.C.§ 404(a)(3)(A)(i)(I). The deductions are limited to an average of twenty-five percent of the participants' compensation. *Id.*

43. 26 U.S.C. § 404(a)(7)(A)(i). The deductions are limited to 25 percent of the participant's compensation. *Id.*

44. 26 U.S.C. § 415(c). The deductions are limited to the lesser of (1) twenty-five percent of the participant's compensation; and (2) the current dollar limit. *Id.*

45. 26 U.S.C. § 415(c)(6). Contributions to repay principal are deductible up to 25 percent of compensation, and contributions to cover interest are deductible without limit. *Id.*

46. *See* Knox, *supra* note 33, at 577-78 (describing the "leveraged ESOPs" use of an "exempt loan" transaction).

47. *Id.*

contributions, the ESOP pays off its loan to the employer, while the employer uses the periodic contributions it received from the ESOP to pay off the lender directly.

Both "leveraged ESOP" scenarios provide advantages to some employers. By using the unique exemptions afforded to ESOPs, the employer is able to use the tax-deductible ESOP contributions to pay off a loan.[48]

> "Much as with debt financing, the employer has raised capital while effectively assuming the obligations to repay a loan. The advantage to the employer is that by utilizing an ESOP rather than a conventional debt, the contributions to the ESOP are fully deductible, including the portion of the contribution that is functionally the equivalent of the repayment of the principal on the loan. The ESOP thereby enables the corporation to finance its capital requirements with pre-tax dollars."[49]

By providing significant benefits to the employer, the introduction of the ESOP exemptions provides employers with incentives to undertake ESOP arrangements to promote employee ownership. In the judgment of Congress and ERISA, ESOPs also redistribute wealth to employees by effectuating employee ownership, which in turn acts as a boon for employees to increase savings and productivity. ESOPs were designed in order to "expand[] the national capital base among employees - an effective merger of the roles of capitalist and worker."[50] ESOPs thus serve as both "a benefit or retirement program and as an employee incentive program."[51]

E. The Problems That Stock Drop Suits Based on ERISA Create

The growth in popularity of EIAPs and ESOPs has led to a host of ERISA stock drop lawsuits - over 90 as of the writing of this article. The lawsuits raise difficult questions regarding the scope of a fiduciary's duty with respect to such plans. In the common case, EIAP or ESOP beneficiary-plaintiffs file suit after a publicly traded company's stock undergoes a significant decline in its value. The plaintiffs allege that the EIAP or ESOP fiduciary violated ERISA fiduciary duties by imprudently investing or

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48. *See* Kenneth Hayes, Note, Moench v. Robertson*: When Must An ESOP Fiduciary Abandon A Sinking Ship?*, 49 RUTGERS L. REV. 1231, 1236 (1997)("Furthermore, the lending institution may, provided certain conditions are fulfilled, exclude 50% of the interest earned on an ESOP loan from its taxable base. The bank, in turn, passes a portion of this tax benefit on to the borrowing corporation in the form of a reduced interest rate.").

49. Fischel & Langbein, *supra* note 24, at 1155.

50. *Donovan*, 716 F.2d at 1458.

51. Hunter C. Blum, Comment, *ESOP's Fables: Leveraged ESOPs and Their Effect On Managerial Slack, Employee Risk and Motivation in the Public Corporation,* 31 U. RICH. L. REV. 1539, 1544 (1997).

continuing to invest in employer stock, thus leading to a decline in the plaintiffs' account balance under the plan.

Although the cases raising these issues have been numerous, the legal results of these ERISA "stock drop" cases have not been consistent or coherent. The primary reason is that ERISA's policy regarding ESOPs and EIAPs places fiduciaries in a difficult position. Under ERISA, fiduciaries are charged with the duty to follow the plan documents so long as the plan documents do not conflict with Titles I or IV of ERISA.[52] On the one hand, by exempting EIAPs and ESOPs from the duty to diversify and the ten percent cap on investments in employer securities, ERISA encourages employers to adopt defined contribution plans that invest, sometimes primarily, in employer stock. Unlike traditional defined benefit plans, the purpose of the ESOP or EIAP - as recognized in both ERISA and the employer's plan documents - is to promote, encourage, and effectuate employee ownership. Accordingly, fiduciaries rightfully believe they are acting in accordance with the plan terms and ERISA when they invest and retain employer stock.

However, while ERISA exempts EIAPs and ESOPs from certain duties, the fiduciary duty of loyalty and a residual duty of prudence remains.

> [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. The investment decisions of a . . . plan's fiduciary are subject to the closest scrutiny under the prudent person rule, in spite of the 'strong policy and preference in favor of investment in employer stock.'"[53]

The fiduciary is thus forced to decide whether the duty of care and the residual duty of prudence ("residual" because the duty to diversify is explicitly exempted by ERISA) requires the fiduciary to choose one ERISA policy over another: the explicit ERISA policy that encourages investment in employer stock versus a general ERISA policy that discourages fiduciaries from making high-risk investments.[54] Even if the fiduciary would want to diversify investments when employer stock declines, the fiduciary is faced

52. 29 U.S.C. § 1107(a)(3)(A).

53. Fink v. Nat'l Sav. and Trust Co., 772 F.2d 951, 955-56 (D.C. Cir. 1985) (citations omitted).

54. *See* Muir & Schipani, *supra* note 9, at 327.

> The real challenge for directors and other ERISA fiduciaries is to reconcile two lines of cases that flow from the conflicts of interest allowed under ERISA. One strand of law imposes absolute loyalty on fiduciaries . . .The other strand of law recognizes that employers may receive 'incidental' and thus legitimate benefits . . . from the operation of a pension plan . . .

Id. (internal citations omitted).

with a difficult decision when ERISA and the plan itself encourage or even require continued investment in employer stock.

Nevertheless, "stock-drop suits" require courts to answer these questions and "find a way for the competing concerns to coexist."[55] In the process of doing so, however, the courts have created more questions than answers. Courts have had difficulty defining the contours of fiduciary duty under ESOPs and EIAPs. Moreover, they have also had difficulties deciding whether the same legal standards should apply to ESOPs and EIAPs, what level of scrutiny is required in such cases, and what is required for a plaintiff to state a claim for violation of fiduciary duty to an ESOP or EIAP. In the next sections, this article explores the divergent paths that stock-drop suits have taken with respect to EIAPs and ESOPs, and explores the *Moench* presumption's impact on stock drop suits.

III. RESOLUTION OF THE CONFLICT: *MOENCH* AND *SCHERING-PLOUGH*

Although the *Moench* ruling has received a mixed response from commentators and courts, one circuit court and a variety of district courts have adopted the *Moench* presumption.[56] The application of *Moench* by these courts has not been uniform; indeed, courts have issued divergent opinions on what stage in litigation the *Moench* presumption applies, what sort of plans the *Moench* presumption applies to, what is required to overcome the *Moench* presumption, and whether the *Moench* presumption is a proper understanding of ERISA's fiduciary duties at all. Nevertheless, the *Moench* opinion is the seminal ERISA stock-drop

55. *Moench*, 62 F.3d at 570.

56. Kuper v. Quantum Chemical Corp., 66 F. 3d 1447, 1459-60 (6th Cir. 1995); *In re* Polaroid ERISA Litig., 362 F.Supp. 2d 461, 474 (S.D.N.Y. 2005); Pa. Fed'n., Bhd. of Maint. of Way Employees v. Norfolk So. Corp., 2004 U.S. Dist. LEXIS 1987, at 21-23 (E.D. Penn. Feb. 4, 2004); *In re* Honeywell Int'l ERISA Litig., 2004 WL 3245931 at *11 (D.N.J. June 14, 2004); *In re* Sprint Corp. ERISA Litig., 388 F.Supp.2d 1207, 1222 (D.Kan. May 27, 2003) (assuming presumption applies without deciding); *In re* Sears, Roebuck & Co. ERISA Litig., 2004 WL 407007 at *4 (N.D. Ill. Mar. 3, 2004). Two circuit courts have considered the Moench presumption but refused to explicitly adopt or repudiate the presumption, deciding the case on other grounds. *See* LaLonde v. Textron, Inc., 369 F.3d 1, 6 (1st Cir. 2004) ("Because the important and complex area of law implicated . . . is neither mature not uniform . . . we believe that we would run a high risk of error were we to lay down a hard-and-fast rule . . . based only on [ERISA's] text and history, the sparse pleadings, and the few and discordant judicial decisions discussing the issue we face."); Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1097-98 (9th Cir. 2004) ("[T]he facts of this case do not necessitate that we decided whether the duty to diversify survives the statutory text of § 1104(a)(2). Plaintiffs' prudence claim is unavailing under any existing approach.").

case, and is thus the starting point for any discussion of stock-drop suits.

A. *The* Moench *Presumption*

Moench involved an ESOP established on behalf of Statewide Bancorp ("Statewide"), which invested solely in employer stock. For a variety of reasons, the value of Statewide's stock began to plummet, eventually culminating in Statewide filing for Chapter 11 bankruptcy protection as well as the loss of substantially all of the ESOP investments.[57] Moreover, during Statewide's financial decline, "federal regulatory authorities repeatedly expressed concern to Statewide's board of directors about the bank's portfolio and financial condition."[58] An employee of Statewide brought suit, arguing that the ESOP fiduciaries – as both board members and plan trustees – had knowledge of Statewide's impending collapse but failed to divest the plan of employer stock, thus breaching ERISA's duty of prudence and loyalty to the plan.[59]

Based upon the plan documents, the *Moench* court found that the primary purpose of the Statewide ESOP was to invest in employer stock.[60] The court then acknowledged that, under ERISA, ESOP fiduciaries are exempted from the duty of prudence, insofar as it requires diversification of investments, as well as the prohibited transactions provisions of ERISA, which are designed to reduce the risk of conflicts of interest and self-dealing.[61] The reason for these specific exemptions, the court noted, "arises out of the nature and purpose of ESOPs themselves."[62] ESOPs are designed for the express purpose of investing primarily in employer securities, and are not intended to guarantee retirement benefits.[63] Rather, employee ownership through purchase of employer securities is "a goal in and of itself" under ERISA - a goal that places employee retirement assets at greater risk for the sake of employee ownership.[64]

Despite ERISA's stated goals with respect to ESOP's, the *Moench* court had to balance the goal of employee ownership via high-risk investment in employer stock against the duty of loyalty and the residual duty of prudence or care. The court acknowledged that the ESOP fiduciary is placed in a tenuous position: at once, the fiduciary must act in accordance with the stated goals of ERISA and the plan, yet also honor the "strict

57. *Moench*, 62 F.3d at 557-58.
58. *See* Hayes, *supra* note 48, at 1249.
59. *Moench*, 62 F. 3d at 559.
60. *Id*. at 568.
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.*

standards" of duty imposed by ERISA.[65] The *Moench* court found that notwithstanding ERISA's stated goals, "cases addressing the duties of ESOP fiduciaries in this area generally have allowed ERISA's strict standards [of fiduciary duty] to override the specific policies behind ESOPs."[66]

In order to articulate a standard that takes account of ERISA's "competing concerns," the *Moench* court looked to the law of trusts, which states, "[w]e can formulate a proper standard of review of an ESOP fiduciary's investment decisions by recognizing that 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."[67] According to the court, ERISA trustees are usually under a duty to diversify the investments.[68] However, under common law trust principles, the duty to diversify investments is waivable by the terms of the trust.[69] In the case of an ESOP, then, the terms of the trust may waive the diversification requirement. Moreover, the fact that ERISA allows ESOPs to waive the diversification requirement "is simply a statutory acknowledgment of the terms of ESOP trusts."[70] In other words, ERISA's diversification exemption is a statutory approval of ESOP terms.

When a fiduciary invests trust funds, the trustee has a duty to the beneficiaries to conform its investment decisions to the terms of the trust and the settlor's intent.[71] "[A] trustee can properly make investments in such properties and in such manner as expressly or impliedly authorized by the terms of the trust."[72] Under the common law of trusts, however, a trustee may be directed to make investments by the trust instrument in two separate and distinct ways: the trustee can be (1) a directed trustee that is mandated or required to invest in a certain stock, in which case the trustee must comply with the investment directive unless compliance with the directive is "impossible . . . or illegal;" or (2) a trustee that is permitted or allowed to make a particular investment, in which case the "fiduciary must still exercise care, skill, and caution in making decisions to acquire or retain the investment."[73]

Based on these principles, the court stated that while the ESOP fiduciary in *Moench* was not "absolutely required to invest

65. *Id*. at 569.
66. *Id.*
67. *Id.* at 571.
68. *Id.*
69. *Id.* (citing RESTATEMENT (THIRD) OF TRUSTS § 227(b)).
70. *Id.* at 571.
71. *Id.*
72. *See id.* (quoting RESTATEMENT (THIRD) OF TRUSTS § 227, cmt (d)).
73. *Id.*

in employer securities," the trustee was "more than simply permitted to make such investments."[74] According to the court, when a trustee operates in this apparent middle-ground - not as a directed trustee, but more constrained to investing in employer stock than a trustee that is "merely permitted" to invest in employer stock - the "fiduciary is *presumptively* required to invest in employer stock."[75] Because these middle-ground fiduciaries are not directed trustees, the court found that they should not be completely immune from judicial scrutiny, as a directed trustee would be.[76] Provided that the middle-ground fiduciary must presumptively invest in employer stock, they should also be excluded from the strict scrutiny regularly afforded to non-ESOP ERISA fiduciaries.[77] Accordingly, the court found that an ESOP fiduciary's decision to continue investing in employer stock should not be subject to a *de novo* review, as is the case for trustees of non-ESOP benefits plans, but instead "should be reviewed for an abuse of discretion."[78]

Bearing in mind the congressional purpose behind ESOPs and the middle-ground status that ESOP fiduciaries occupy with respect to the common law of trusts, the *Moench* court formulated a test - now called the *Moench* presumption - for deciding when an ESOP fiduciary commits an abuse of discretion by failing to divest from employer stock.

> [We] hold that in the first instance, an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities.[79]

The *Moench* court further commented on what may be required for plaintiffs to overcome the presumption. To establish an abuse of discretion, the court ruled that plaintiffs "must show that the ERISA 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."[80] When deciding such cases, the *Moench* court reminded future courts that an ESOP fiduciary may be cautious to divest employer stock, because the fiduciary may incur liability if the

74. *Id.*
75. *Id.* (emphasis added).
76. *Id.* The court in *In re McKesson* recognized this distinction in Moench and explored its trust law foundations. *In re* McKesson, 391 F.Supp. 2d 844 (N.D. Cal. 2005).
77. *Moench*, 62 F.3d at 571.
78. *Id.*
79. *Id.*
80. *Id.*

employer's stock thrives.[81] It also advised future courts to remember that when a company's financial state deteriorates, "ESOP fiduciaries who double as directors of the corporation often begin to serve two masters."[82] This may create uncertain loyalties that affect the fiduciary's ability to investigate investment decisions on behalf of the plan, with an impartial eye to the best course of action. Lastly, the court found the Statewide fiduciaries had knowledge of Statewide's impending collapse, but because of their own conflicts of interest, abused their discretion by failing to contract out investment decisions to an "impartial outsider."[83]

B. The Schering-Plough *Opinion*

The *Moench* opinion addressed an ESOP; the plan was designated as such, and thus designed to invest primarily in employer stock.[84] After *Moench*, a number of courts expanded the holding beyond the ESOP context, applying the *Moench* presumption to EIAPs as well, usually 401(k) plans.[85] According to these courts, applying the *Moench* presumption to EIAPs as well was the only intelligible option because EIAPs, like ESOPs, are exempted from ERISA's diversification requirement and the ten percent limitation on investments in employer securities.[86] As such, an EIAP can be utilized in the same manner as an ESOP, investing heavily in employer securities and providing partial ownership to employees. Accordingly, these courts have likened ESOPs to EIAPs, and applied the presumption to both. Although the question of whether the *Moench* presumption should be applied to both ESOP and EIAP fiduciaries was initially an open issue, applying the *Moench* presumption to both EIAPs and

81. *Id.* at 571-72.

82. *Id*. at 572.

83. *Id.*

84. *See* 29 U.S.C. § 1107(d)(6)(A) (stating that an ESOP is a stock bonus plan or combined stock bonus and money purchase plan that is "designed to invest primarily in employer securities").

85. *See* Wright v. Oregon Metallurgical Corp., 360 F.3d 1090, 1098 n.3 (9th Cir. 2004) (finding that the *Moench* holding applies to EIAPs and ESOPs); *In re* Polaroid ERISA Litig., 362 F.Supp. 2d 461, 474 (S.D.N.Y. 2005) (stating that *Moench* applies "with equal force to 401(k) plans requiring that that the employer's stock be an investment option"); *In re* Syncor ERISA Litig., 351 F.Supp. 2d 970, 979 n.5 (C.D. Cal. 2004) ("ESOPs and EIAPs are treated the same for a fiduciary duty analysis."); *In re* Honeywell Int'l ERISA Litig., 2004 WL 3245931 at *11 n.5 (D.N.J. June 14, 2004) (stating that "an EIAP no less than an ESOP calls for investment in employer securities, and it would seem appropriate to give the same deference to either case).

86. *See* Wright, 360 F.3d at 1097 n.2 ("Unlike traditional pension plans governed by ERISA, EIAPs - and ESOPs in particular - are not intended to guarantee retirement benefits and indeed, by their very nature, 'place employee retirement assets at a much greater risk than does the typical diversified ERISA plan.'") (citation omitted).

ESOPs became so common to courts that the practice was rarely questioned.

The Third Circuit, however, revived the issue in a subsequent opinion, *In re Schering-Plough Corporation ERISA Litigation*.[87] In *Schering-Plough*, the plan beneficiaries participated in a 401(k) plan - an EIAP - that allowed the beneficiaries to select from different investment funds.[88] One of the investment funds was the Schering Plan Company Stock Fund, which consisted of Schering-Plough stock. Participants under the plan were not allowed to invest more than 50% of their future contributions in Schering-Plough stock.[89] A large percentage of the employees participated in the savings plan, and over 30% of the value of the plan's assets was made up of Schering-Plough stock.[90] Over a two-year period, Schering-Plough stock fell dramatically, leading to a class action lawsuit for breach of fiduciary duty on behalf of the beneficiaries of the plan.[91]

The district court in *Schering-Plough* found that plans which allow employees to become part owners of their company are effectively ESOPs, thus requiring application of the *Moench* presumption.[92] The Third Circuit disagreed, holding that because ESOPs are distinct from EIAPs in that ESOPs are designed to invest *primarily* in employer stock, they are of a different character than other defined contribution plans. As the court noted, "[t]he Plan before us was designed to provide opportunities for saving and investment. It was not designed to invest *primarily* in securities of the employer. Indeed, the Plan was not required to offer Schering-Plough stock as one of its investment opportunities."[93] The court went on to state that "[w]e find our *Moench* decision inapposite because the fiduciaries here were *simply permitted* to . . . make investments in employer securities."[94]

IV. REEVALUATING *MOENCH*: CAN THE PRESUMPTION ITSELF BE RECONCILED WITH ERISA?

The underlying theory of *Moench* is that ESOP fiduciaries, although entitled to a presumption in their favor, may be held

87. 420 F.3d 231 (2005).
88. *Id.* at 232-33.
89. *Id.* at 233.
90. *Id.*
91. *Id.*
92. *Id.* at 237.
93. *Id*. at 236. (emphasis added).
94. *Id.* at 238 n.5 (emphasis added). The court also did not consider significant the argument that part of the plan - the part that invested in employer securities - was an ESOP. *See also* DiFelice v. U.S. Airways, 397 F. Supp. 2d 758, 772 n.15 (E.D. Va. 2005) (adopting the logic of Schering-Plough).

liable for failures to divest employer stock. Further, the *Schering-Plough* court limits the *Moench* presumption to ESOP fiduciaries - non-ESOP EIAP fiduciaries receive no protection from liability by way of the presumption.

If, however, *Moench* does not accommodate the exemption from the duty to diversify for all EIAP fiduciaries, how can *Moench* be reconciled with ERISA? One answer to this question draws a distinction between the fiduciary's failure to sell or purchase stock and the fiduciary's failure to diversify the plan's holdings. The mere fact that fiduciaries are exempted from the duty to diversify holdings of stock does not mean that it is prudent to hold a particular stock, whether the plan holds that stock predominantly or not.[95] In other words, the duty to diversify and the failure to prudently invest are separate and distinct concepts; in stock-drop cases, the beneficiary is not suing because the employee is imprudent in holding the stock *predominantly* - this would be a suit based upon the duty to diversify - the employee is suing because the fiduciary is imprudently holding the stock *at all*.[96] As such, a finding that a fiduciary failed to prudently divest stock does not necessarily lead to a finding that the fiduciary failed to diversify the plan's holdings. The holding of predominantly one stock, which is allowed under ERISA and does not violate the duty to diversify, can nevertheless be imprudent. The point of *Moench* is that holding a fiduciary liable for imprudence requires a finding that the fiduciary possessed the requisite discretion that would make him or her responsible for the imprudent decision.[97]

The problem with this explanation, however, is that if its logic is extended, a finding that an EIAP fiduciary imprudently invested in employer stock ultimately imposes the duty to diversify on EIAP fiduciaries. This is because EIAPs and ESOPs

95. *See* In re JDS Uniphase Corp. ERISA Litig., 2005 WL 1662131 at * 7 (C.D. Cal. July 14, 2005).

> But plaintiffs do not claim that defendants breached their duty by putting a certain percentage of funds in JDSU stock, or that defendants should have invested certain percentages of Plan assets in various alternative investments. Rather, plaintiffs allege that *any* investment in JDSU stock was imprudent in light of what the defendants knew about JDSU and the risk of investing in JDSU stock.

Id.

96. *See id.* (discussing the differences between the duty to diversify and the duty of prudence).

97. Of course, if plaintiffs wish to pursue a claim against a directed or middle-ground fiduciary for imprudently investing in employer stock, they must bear a heavy burden under *Moench*. As has been noted repeatedly in this article, however, this burden does not exist because of the exemption from the duty to diversify, it exists because the nature of an EIAP or ESOP in most circumstances cuts back on the discretion of fiduciaries, such that they cannot be held liable for a failure to divest. *See supra* Part – III A and accompanying notes.

are only exempted from the ten percent cap on investments and the duty to diversify for investments in *employer* stock. If a fiduciary decides - as a matter of prudence - that primary investment in employer stock is no longer in the interests of the plan, ERISA does not allow the fiduciary to divest the employer stock and reinvest primarily in the stock of *another* company. The only option left to the EIAP fiduciary after deciding to divest employer stock is to invest in a diversified portfolio of equity and debt instruments. Consequently, if a court finds that an ERISA fiduciary should have divested the plan's primary holdings in employer stock, that court is essentially telling the EIAP fiduciary that he or she should have sold the employer stock *and then* diversified the investments of the plan. Indeed, based on ERISA's employer-stock-only-exemption, the fiduciary could do nothing else. Accordingly, the duty to diversify is being imposed by *Moench* - albeit through the back door - on *all* EIAP fiduciaries.

A. Moench *and The Statutory Text of ERISA*

If *Moench* is reevaluated, it is questionable whether the ruling stands on solid footing with respect to ESOPs and EIAPs generally. First, with respect to ESOPs, the very idea that an ESOP fiduciary is "presumptively required" to invest primarily in employer stock seems to result from a mistaken premise about ERISA. In fact, it appears that the *Moench* court adopted a faulty premise by treating ERISA's ESOP provisions as though they merely expressed a policy in favor of investment in employer stock.[98] With respect to ESOPs, *Moench* analogized ERISA's exemption from the diversification requirement to a trust instrument that waives the requirement of diversification of assets.[99] As such, it viewed the ERISA sections dealing with ESOPs as merely permissive, or in other words, merely *allowing* fiduciaries to invest heavily in employer stock, while only the ESOP plan terms would *require* the fiduciaries to invest in employer stock.[100] Indeed, this was the basis for the court's finding that ESOP fiduciaries are middle-ground fiduciaries, and for finding that the plan terms mandating investment in employer

98. *See Moench*, 62 F.3d at 568-71 (referring to ERISA's ESOP provisions as "policies," intimating that ERISA has strong preference in favor of ESOPs).

99. *See id.* at 571 ("And while trustees . . . are 'under a duty to diversify the investments of the trust,' . . . that duty is waivable by the terms of the trust. . . Seen in light of these principles, the provision in ERISA exempting ESOPs from the duty to diversify is simply a statutory acknowledgment of the terms of ESOP trusts.") (citations omitted) (quoting RESTATEMENT (THIRD) OF TRUSTS § 227(b)).

100. *See id.* at 571 (stating that 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 "the trust serves a purpose explicitly approved and encouraged by Congress").

stock could be overridden by ERISA. However, ESOPs are not structured in a merely permissive way. In fact, the law for ESOPs *requires* that the plan invest primarily in employer stock for it to be designated as an ESOP.[101] Section 1107(d)(6)(A) of ERISA explicitly defines an ESOP as a stock bonus plan or stock bonus and money purchase plan that primarily invests in employer stock. The very definition of an ESOP thus requires ESOP fiduciaries to invest primarily in employer stock. Outside of the ERISA and Treasury Regulations sections, ESOP plan terms - in order to remain consistent with ERISA's mandate - also *require* fiduciaries to invest primarily in employer stock. Once the ESOP divests employer stock below 50% over the life of the plan, according to ERISA, Treasury Regulations, and the DOL, it is no longer an ESOP.[102] It seems unlikely that ERISA would require an ESOP fiduciary, contrary to the plan terms, ERISA itself, and ancillary laws, to abolish the ESOP in order to satisfy his responsibilities as an ESOP fiduciary.

The second problem with *Moench* is that the opinion treated the duty to diversify investments for all EIAPs as though it were also a policy prerogative of ERISA. According to ERISA, all EIAPs are exempted from the diversification requirement. Section 404 of ERISA explicitly states that "the diversification requirement . . . and the prudence requirement (only to the extent it requires diversification) . . . *is not violated* by acquisition or holding of [company stock]."[103] This congressional imperative is expressed as a statutory rule, not a statement of policy or general purpose. Of course, under particular circumstances, what is meant by "diversification" and how diversification relates to the fiduciary duty of prudence may be unclear. What is clear, however, is that a fiduciary's decision whether to divest employer stock falls squarely within the duty to diversify, a duty from which the EIAP fiduciary

101. Treas. Reg. § 54.4975-11(b)(2004); *See* D.O.L. Op. No. 83-6 A (Jan. 24, 19832) (stating that investment in employer securities must comprise "more than 50% of its assets" which will be measured "over the life of the plan").

102. This leads to the conclusion that because all ESOPs are *required* by the plan, ERISA, and the Treasury Regulations to invest primarily in employer stock, all ESOP fiduciaries are akin to directed fiduciaries, not middle-ground fiduciaries that are presumptively required to invest in employer stock. Relying on the law of trusts, such fiduciaries would only be able to divest employer stock if there was an emergency or the fiduciary was directed or permitted by a court to divest employer stock. *See* RESTATEMENT (SECOND) OF TRUSTS § 167(1), (2) (1957) (permitting the trustee to deviate from the trust upon the court's direction or in case of emergency). Although this article has noted that *Moench* could contemplate the existence of directed fiduciaries - as noted by the court in *McKesson* - the fact that ESOP fiduciaries are actually directed fiduciaries subverts the entire premise of *Moench*, which was that ESOP fiduciaries are not merely permitted or directed to invest in employer stock, but instead are presumptively required to invest in employer stock.

103. 29 U.S.C. § 1104(a)(2).

is specifically exempted. There is nothing inconsistent about imposing the duties of prudence and loyalty on EIAP fiduciaries, while nevertheless exempting these fiduciaries from the duty to diversify. It may be problematic to enforce the exemption, insofar as the exemption precludes a number of claims against EIAP fiduciaries and exposes employees to increased risks. However, if the meaning of the statute's text is plain, the courts must enforce that statute as Congress drafted it.[104] Under ERISA's unequivocal language, then, *all* EIAP fiduciaries "may 'hold' company stock even when a prudent fiduciary would diversify the plan."[105]

The third concern raised by *Moench* is the conclusion that "cases addressing the duties of ESOP fiduciaries in this area generally have allowed ERISA's strict standards to override specific policies behind ESOPs."[106] Because the precedents relied upon by *Moench* do not necessitate its finding of a residual duty to diversify, the *Moench* court may have misunderstood precedent in conceiving the *Moench* presumption. In *In re McKesson*, the court reviewed the precedents relied upon by *Moench* and concluded that those cases did not hold that an ESOP fiduciary may be held liable for a failure to diversify an ESOPs investments.[107]

> Instead, these cases reveal that ESOP fiduciaries can be liable for engaging in *other forms of imprudence*: paying too much for employer securities, charging a commission, or acquiring stock for prohibited reasons. *Moench* questionably jumps from the premise that ESOP fiduciaries are *generally* subject to the duty of prudence to the determination that ESOP fiduciaries may breach the duty of prudence by refusing to sell company stock.[108]

Moreover, the *McKesson* court noted that in each case cited by *Moench*, the respective courts recognized the duty to diversify does not apply to ESOP fiduciaries, although the residual duty of prudence remains.[109] According to *McKesson*, the *Moench* court

104. *See*, *e.g.,* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) ("[W]hen the statute's language is plain, 'the sole function of the courts' - at least where the disposition required by the text is not absurd - 'is to enforce it according to its terms.'").

105. *In re* McKesson HBOC, Inc. ERISA Litig., 391 F. Supp. 2d 812, 825 (N.D. Cal. 2005).

106. *Moench*, 62 F.3d at 569.

107. *See In re McKesson*, 391 F. Supp. 2d at 825-27 (discussing Eaves v. Penn, 587 F.2d 453 (10th Cir. 1978); Donovan v. Cunningham, 716 F.2d 1455 (5th Cir. 1983); Martin v. Feilin, 965 F.2d 660 (8th Cir. 1992); and Fink v. Nat'l Sav. & Trust Co., 772 F.2d 951 (D.C. Cir. 1985)). The McKesson court notes that one case relied upon by Moench, Canale v. Yegen, 782 F. Supp. 2d 963, 967 (D.N.J. 1992), actually misapplies *Fink* for the assertion that an ESOP fiduciary may be held liable for a failure to diversify. *In re* McKesson, 391 F. Supp. 2d at 825.

108. *In re* McKesson, 391 F. Supp. 2d at 827 (footnote omitted).

109. *Id*. at 825-27. *See Eaves*, 587 F.2d at 460 ("ESOP fiduciaries are subject to the same fiduciary standards as any other fiduciary except to the extent

overstated the potential conflict between ERISA's fiduciary duties and ERISA's exemptions for ESOPs. Although ERISA's exemptions may require courts to redefine the scope of fiduciary duty with respect to ESOPs generally, the statute itself struck a balance that the *Moench* court could not reevaluate, at least to the extent that it imposed a residual duty to diversify on ESOP fiduciaries. As the court noted, there is "nothing inconsistent with section 404 simultaneously (1) imposing a multifaceted duty of prudence upon ESOP fiduciaries and yet (2) exempting them from one particular aspect of it: the duty to diversify."[110]

It should be noted that although the *McKesson* holding addressed itself to ESOPs only, ERISA's exemption from the duty to diversify applies to EIAPs generally. Therefore, all EIAPs are included in the *McKesson* court's analysis. The appeal to trust law, or the fact that fiduciaries under non-EIAPs and ESOPs may occupy different roles and be constrained by the plan and ERISA in different ways, which was so important in *Moench* and *Schering-Plough*, has no bearing on this conclusion. The law of trusts cannot override the explicit statutory terms of ERISA.[111] While the law of trusts can and should be used to "gain definition" of the duties imposed by ERISA on fiduciaries, "the usefulness of trust law to decide cases brought under ERISA is constrained by the statute's provisions."[112] Accordingly, the extent that ERISA's exemptions cut back upon the usual fiduciary duties under the common law of trusts is the extent to which the law of trusts must yield to ERISA.

B. EIAPs v. ESOPs

The legislative history of section 404 also reveals no distinctions between ESOPs and non-ESOP EIAPs with respect to the exemption from the duty to diversify, and in fact reflects a

that the standards require diversification of investments."); *Donovan*, 716 F.2d at 1467 & n.25 ("ESOP fiduciaries remain subject to the general requirements of Section 404 . . . [e]xcept those relating to diversification."); *Martin*, 965 F.2d at 665 ("[T]he special statutory rules applicable to ESOPs . . . inevitably affect the fiduciary's duties under [section 404]."); *Fink*, 772 F.2d at 955 ("In addition, the requirement of ERISA that a plan diversify its assets, does not apply to the holding of employer securities by [ESOPs].").

110. *In re* McKesson, 391 F. Supp. 2d at 826.

111. *See*, *e.g.*, Harris Trust & Sav. Bank v. Salomon Smith Barney, Inc., 530 U.S. 238, 250 (2000) (stating, "The common law of trusts 'offers a starting point for analysis [of ERISA] . . . [unless] it is inconsistent with the language of the statute, its structure, or its purposes.'") (quoting Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 447 (1999)); Varity Corp. v. Howe, 516 U.S. 489, 497 (1996) ("We also recognize . . . that trust law does not tell the entire story.").

112. *In re* Enron Corp. Securities, Derivative & ERISA Litig., 284 F. Supp. 2d 511, 546 (S.D. Tex. 2003) (internal citations omitted).

concern with courts creating a duty to diversify after Congress had explicitly abolished it. As the Senate Report states:

> It is emphasized, however, that even with respect to the transactions expressly allowed [under section 408 of ERISA], the fiduciary's conduct must be consistent with the prudent man standard. In recognition of the special purpose of profit-sharing *and similar plans*, the [10%] limitation does not apply to such plans if they explicitly provide for greater investment in the employer securities, *nor should any diversification principle that may develop from application of the prudent man principle be deemed to restrict investment by profit-sharing plans in employer securities* . . . .[113]

Later, when passing the Tax Reform Act of 1987, Congress reiterated its concern that courts would equate ESOPs to conventional retirement plans.

> The Congress is deeply concerned that the objectives sought by [the group of laws regarding ESOPs] will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trusts and employers to take necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.[114]

These passages suggest that it is a misguided strategy for courts to attempt to read in a fiduciary duty to diversify investments when no such duty exists under ERISA. If ERISA explicitly exempts all such fiduciaries from the duty to diversify, imposing such a requirement improperly "attempt[s] to adjust the balance . . . that the text adopted by Congress has struck."[115]

While there are meaningful distinctions between ESOPs and EIAPs under the tax rules, discussed in Part II of this article, the only meaningful distinction between an ESOP and EIAP under ERISA is that an ESOP must "invest primarily" in company stock, while EIAPs have no such requirement. To the extent the *Schering-Plough* court relies on this distinction, it is imposing a diversification requirement on EIAPs in spite of the fact that EIAPs are also exempted from diversification requirements under ERISA 404(a)(2). Because this exemption applies to all EIAPs, the same standards of prudence should apply to EIAPs and ESOPs, regardless of whether the plan is invested 100% in company stock or 1% in company stock. According to ERISA, the exemption from the duty to diversify is identical with respect to both. Thus under

113. S. REP. NO. 93-127, 93d Cong., reprinted in U.S.C.C.A.N. 4838, 4867-69 (emphasis added).
114. Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1590 (1976).
115. Mertens v. Hewitt Assocs., 508 U.S. 248, 263 (1993).

ERISA, what is left of the duty of prudence should also be identical with respect to both EIAPs and ESOPs.

Moreover, to the extent that *Schering-Plough* relies on the notion that ESOPs have a "special purpose" - to encourage employee ownership - in applying the *Moench* presumption only to ESOPs, the *Schering-Plough* opinion misses the mark. EIAPs, just as much as ESOPs, fulfill the purpose of encouraging employee ownership. As the court in *In re Honeywell* noted, "[t]he argument for similar treatment of [ESOPs and non-ESOP EIAPs] appears to be a strong one: an EIAP no less than an ESOP calls for investment in employer securities, and it would seem appropriate to give the same deference in either case to fiduciary decisions that conform to the demands of the plan."[116]

C. Does Moench *and its Progeny Encourage Violations of the Securities Laws?*

Various courts have also raised the concern that *Moench* may encourage corporate officers to violate securities laws in order to escape fiduciary liability.[117] Under Rule 10b-5 of the Securities Exchange Act:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[118]

The fact that ERISA fiduciaries may wear "two hats" becomes particularly important in this regard.[119] Under this doctrine, the employer "may function in a dual capacity as a business

116. *In re* Honeywell, 2004 U.S. Dist. LEXIS 21585 at *38 n.15.

117. *See*, *e.g.*, Wright, 360 F.3d at 1098 n.4 (stating a concern for encouraging inside information); *In re* Enron Corp. Securities, Derivative & ERISA Litig., 284 F. Supp. 2d at 546 (recognizing the concern of a dual role for a plan fiduciary); Hull v. Policy Management Systems Corp., 2001 WL 1836286 at 4-5 (D.S.C. Feb. 9, 2001).

118. Employment of Manipulative and Deceptive Devices, 17 C.F.R. § 240.10b-5 (2004). *See generally*, Martin & Fine, *supra* note 6 at 891-95 (providing a general overview of Rule 10b-5 and its requirements).

119. *See* Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995) (adopting the "two hats" doctrine).

employer . . . whose activity is not regulated by ERISA and as a fiduciary of its own established ERISA plan, subject to ERISA."[120] As such, the ERISA fiduciary is particularly susceptible to conflicts of interest as both a corporate insider and a plan administrator.

> Unlike the trustee at common law, who must wear only his fiduciary hat when he acts in a manner to affect the beneficiary of the trust, an ERISA trustee may wear many hats, although only one at a time, and have financial interests that are adverse to the interests of beneficiaries but in the best interests of the company.[121]

Because EIAPs tend to invest heavily in company stock, the employer's possession of material, non-public information about the financial state of the company creates a greater than usual risk of self-dealing and conflicts of interest. The fact that *Moench* and its progeny refuse to shield EIAP fiduciaries from the duty to diversify presents a still greater risk because an employer/fiduciary may be encouraged to sell or acquire employer stock based upon insider information in order to avoid liability under *Moench*. Accordingly, while the "two hats" doctrine already places a great deal of pressure on employer/plan fiduciaries, creating a host of conflict of interest problems, the problems are only exacerbated in the EIAP context because of how dependent EIAPs can be on employer stock, and the fact that *Moench* imposes a residual duty to diversify on EIAP fiduciaries. The EIAP fiduciary is thus placed in a precarious position in which the interests of the plan's beneficiaries, as envisioned by *Moench*, run counter to the securities laws.

Another insider trading problem arises if *Moench* is read to require fiduciaries to selectively disclose material, non-public information to beneficiaries, but not the public at large. ERISA has a "comprehensive set of reporting and disclosure requirements."[122] In addition to Summary Plan Descriptions, which include everything from the plan's sources of financing to the names and addresses of the people who exercise authority over the plan, ERISA also requires plan administrators to disclose specific information to plan participants regarding the health of the plan.[123] Because ERISA's disclosure scheme is comprehensively addressed in Part I of ERISA, the Supreme Court has held that as a general proposition, if a fiduciary complies with the disclosure requirements of Part I, his fiduciary duty to disclose information to beneficiaries under ERISA has been satisfied.[124]

120. *Enron*, 284 F. Supp. 2d at 551.
121. *Id.* at 550.
122. *Schoonejongen*, 514 U.S. at 83 (internal quotations omitted).
123. 29 U.S.C. § 1022(b), 1023, and 1024(b).
124. *See Schoonejongen*, 514 U.S. at 84 (stating that Part I "may not be a foolproof informational scheme, although it is quite thorough. Either way, it is

However, both in the EIAP context and outside of it, plaintiffs have argued that the duty of prudence from § 404(a) of ERISA imposes further obligations of affirmative disclosure upon fiduciaries. Under the common law of trusts, trustees have a "duty to communicate to the beneficiary material facts affecting the interest of the beneficiary which he knows the beneficiary does not know and which the beneficiary needs to know for his protection in dealing with a third person with respect to his interest . . ."[125] Instead of reading this provision of trust law expansively - which "could require fiduciaries to disclose every piece of information that it is privy" and "render meaningless the detailed disclosure requirements of ERISA"[126] - courts have generally held that there is a further duty of affirmative disclosure under only two circumstances.[127] First, there is an affirmative duty to disclose information when a participant requests further information regarding the plan. Once a participant initiates such an inquiry, the fiduciary is generally required to provide the participant with complete, accurate, and material information regarding the inquiry. Second, there is an affirmative duty to disclose when the fiduciary is aware of the fact that plan participants are operating under a material misunderstanding of the plan's terms. This includes material misunderstandings, which are "fostered by the fiduciary's own material misrepresentations or omissions."[128] Under either prong –

the scheme that Congress devised. And we do not think Congress intended it to be supplemented by a far-away provision in another part of the statute . . ."); Faircloth v. Lundy Packing Co., 91 F.3d 648, 657 (4th Cir. 1996) (stating that when dealing with such a comprehensive statute, the principle of statutory interpretation which requires a statute's specific provision to govern general provisions is particularly suited to ERISA's disclosure requirements).

125. RESTATEMENT OF THE LAW SECOND: TRUSTS § 173 cmt. d (1957).

126. *Difelice v. Fiduciary Counselors, Inc.*, 398 F. Supp. 2d 453, 465 (D. Va. 2005).

127. The Supreme Court has not reached the issue of whether ERISA fiduciaries have a "duty to disclose truthful information on their own initiative, or in response to employee inquiries." Varity Corp. v. Howe, 516 U.S. 489, 506 (1996).

128. Griggs v. E.I. DuPont De Nemours & Co., 237 F.3d 371, 381 (4th Cir. 2001). For both affirmative duties, courts have devised different tests for determining what information is material. *Id*. *See also* Barnes v. Lacy, 927 F.2d 539, 544 (11th Cir. 1991), *cert. denied*, 502 U.S. 938 (1991) (proposing one test by the Eleventh Circuit, which ruled that when a participant requests information, the fiduciary has an obligation to inform plan participants when proposed changes to the plan are under "serious consideration." . Similarly, if the participant's claim is based upon a misrepresentation, the misrepresentation must have been with respect to a plan term or change to the plan that was under "serious consideration." *Id.*; Hockett v. Sun Co., Inc., 109 F.3d 1515, 1522-25 (10th Cir. 1997) (adopting the "serious consideration" test); Muse v. Int'l Bus. Mach. Corp., 103 F.3d 490, 493-94 (6th Cir. 1996), *cert. denied*, 520 U.S. 1240 (1997) (same); Wilson v. Southwestern Bell Tel. Co., 55

participant inquiry or fiduciary misrepresentation – the diversification duty imposed by *Moench* could lead to a requirement that ERISA fiduciaries selectively disclose material, non-public information to participants.

Yet, selective disclosure would also violate federal securities laws regarding insider trading.[129]

> [A] fiduciary's duty of loyalty should not be construed to require him to enable and encourage plan participants to violate the law, i.e., to sell their stock at artificially high prices to make a profit and avoid loss before disclosure of Enron's financial condition was made public. Nor would selective disclosure of that information by the fiduciary to plan participants protect any lawful financial interests of the plan participants and beneficiaries. Like any other investor, plan participants have no lawful right, before anyone else is informed of Enron's negative financial picture, to profit from fraudulently inflated stock prices or to avoid financial loss by selling early before public disclosure.[130]

Conscious of this fact, courts like the Enron court - as well as the Department of Labor (DOL) - have pointed to ways in which the federal securities laws and ERISA fiduciary duties could be harmonized. As the *Enron* court noted, it is better that the ERISA fiduciary comply with both ERISA and the securities laws if the fiduciary is aware of material information, rather than shielding the fiduciary from liability if disclosure would violate the securities laws.

Defendant's argument that despite the duty of loyalty, a fiduciary should make no disclosure to the plan participants, because under the securities laws he cannot selectively disclose nonpublic information, translates in essence into an argument that the fiduciary should both breach his duty under ERISA and, in violation of the securities laws, become part of the alleged fraudulent scheme to conceal Enron's financial condition to the

F.3d 399, 405 (8th Cir. 1995) (same); Vartanian v. Monsanto Co., 14 F.3d 697, 702 (1st Cir. 1994)(same). The other test, proposed by the Second Circuit, is an *ad hoc* approach, which takes into account a variety of factors, much like the materiality test under the securities laws. Ballone v. Eastman Kodak Co., 109 F.3d 117, 120, 122-24 (2d Cir. 1997); *see also* Wayne v. Pacific Bell, 238 F.3d 1048, 1050-51, 55 (9th Cir. 2001), *cert. denied*, 534 U.S. 814 (2001) (adopting the Ballone approach); Martinez v. Schlumberger Ltd., 338 F.3d 407, 428 (5th Cir. 2003) (holding that "[n]otwithstanding our rejection of serious consideration as a bright line rule. . . the lack of serious consideration does not equate to a free zone for lying").

129. 17 C.F.R. § 240.10b-5. *See also* 15 U.S.C. § 78u-1(a)(1)(B) (imposing civil penalties for insider trading against a person who directly or indirectly controlled a person who sold a security while in possession of such material, nonpublic information or violated the law in communicating such information).

130. *Enron*, 284 F. Supp. 2d at 565.

continuing detriment of current and prospective Enron shareholders, which include his plan participants.

According to the DOL and the *Enron* court, ERISA fiduciaries *must* disclose material information that is "essential to protect the interests of the beneficiaries."[131] In their view, the *Enron* fiduciaries could have satisfied both ERISA and federal securities requirements by (1) disclosing the material, non-public information to the beneficiaries, shareholders and the public at large; (2) eliminating Enron stock as investment option for the plan in the future; or (3) informing the SEC or DOL that misstatements were made to participants regarding Enron's financial condition.[132]

The first thing to notice is that "harmonizing" ERISA and the securities laws in this case is actually equating the requirements of ERISA to those of the securities laws. The DOL and *Enron* court would provide to beneficiaries under ERISA what is already available under the securities laws for false statements and omissions. If the plaintiffs bring a case that is not based upon false statements or omissions, however, there can be no selective disclosure without violating insider-trading laws. The second thing to notice about the DOL's suggestions is that only the second option - eliminating Enron stock as an investment option in the future - would avoid revealing information to the public at large. Of course, the most preferable route for employers in these cases would be to pursue the DOL's second option and eliminate employer stock as an investment option in the future. However, the ERISA fiduciary cannot sell the employer stock that the plan *already holds* based upon confidential non-public information, because such a "purchase or sale" would violate insider-trading laws. Eliminating a future investment option, then, would do little to curtail any damage done to the plan.

The only other options proposed by the DOL would make public the material information. While this may encourage ERISA fiduciaries to avoid concealment, requiring public disclosure of non-public information under ERISA would dramatically harm the company's stock prices because "any such disclosure would immediately cause the company's stock price to drop."[133] As such, the DOL's proposal encourages disclosure, but at the certain expense of the stock of the employer, and hence the employee's

131. Amended Brief of the Secretary of Labor as Amicus Curiae, Tittle v. Enron Corp. 284 F. Supp. 2d 511 (S.D. Tex. 2003) (quoting McDonald v. Provident Indemnity Life Ins. Co., 60 F.3d 234 (5th Cir. 1995)).

132. *Id*.

133. *McKesson*, 391 F. Supp. 2d at 837. *See also* West v. Prudential Sec., Inc., 282 F.3d 935, 938 (7th Cir. 2002) (stating that "few propositions in economics are better established than the quick adjustment of securities prices to public information.").

accounts. Moreover, it puts the ERISA fiduciary to the difficult decision of whether a piece of non-public information that need not expressly be disclosed under ERISA is nevertheless material, and more importantly, whether it is prudent to jeopardize the plan by revealing such information to the general public.

V. CONCLUSION

Although the *Moench* presumption contradicts ERISA's explicit exemption from the duty to diversify, *Moench* has emerged as a useful standard that allows courts to begin to grapple with the difficult issues presented by ERISA stock drop cases. The controversy and confusion surrounding *Moench* would be lessened, however, by extending its logic to include all EIAPs. As has been noted, *Moench*'s fundamental justification is that because of competing policies in ERISA and the common law of trusts, the ERISA diversification exemption somehow does not mean what it says. However, both the text of the statute and the legislative history of its passage indicate that EIAPs were meant to be exempted from this requirement, and that courts should avoid finding any remaining duty to diversify for EIAP fiduciaries. As such, the diversification exemption is not an ERISA policy but a statutory directive. ERISA simply does not, based upon a plain reading of the statute alone, allow EIAP fiduciaries to he held liable for a failure to diversify investments. It is this fundamental contradiction between the text of ERISA and the *Moench* opinion that leads to the threat of securities violations - a pressure that would not exist for EIAP fiduciaries if the diversification exemption was honored.

To be sure, there is nothing logically inconsistent about imposing ERISA's rigorous fiduciary duties on EIAP fiduciaries while exempting them from the duty to diversify investments. The duty to diversify investments is but one of many duties imposed by ERISA on EIAP fiduciaries. Outside of diversification, plaintiffs may bring suit for failures on the part of a fiduciary to investigate and evaluate investment options, against the corporation's directors for failing to monitor the appointed fiduciaries, failures to provide complete and accurate information to beneficiaries, failures to avoid conflicts of interest, and other general duties associated with loyalty and prudence. Additionally, beneficiaries may bring claims based upon the securities laws for material omissions and misstatements.

Nevertheless, there is no denying that a flat exemption from the duty to diversify substantially limits the plaintiff's incentive to bring suit because the losses associated with a failure to diversify are probably the highest.[134] The exemption is particularly

134. *See* Fink v. Nat'l Savings & Trust Co., 772 F.2d 951, 962 (D.C. Cir.

crippling for stock-drop suits because in most cases, the various duties summoned by stock-drop plaintiffs are used as a means to hold the fiduciary liable for a failure to sell company stock, which falls directly within the duty to diversify investments. For example, although the duty to investigate and evaluate is separate and distinct from the duty to diversify, a breach of the duty to investigate and evaluate may be used as evidence of a breach of the duty to diversify. As such, applying the flat exemption from liability for failing to diversify would lead to the end of stock-drop cases based upon ERISA.

In the end, courts may consider it a more desirable goal to protect employees' accounts through the *Moench* presumption, potentially finding liability for failures to diversify. Courts may also find it to be a desirable goal to fuse the interests of the securities laws and ERISA such that corporate fiduciaries are encouraged to reveal fraudulent practices or breaches of fiduciary duty to the public, its shareholders, and shareholder employees, rather than concealing information in order to protect the interests of the employer. However, this is not the regime envisioned by ERISA. The primary purpose of EIAPs, unlike the traditional ERISA retirement savings regime in which the interest of the employer and employee were separated, is to encourage employee ownership by fusing the interests of the employer and employees by giving the employees a stake in the future of the company. At least for EIAPs, Congress envisioned that the traditional dichotomy between employer and employee, so common to the courts, would not apply – the interests of the employers and employees would be largely the same. This enterprise was meant to be high-risk, and as the ERISA drafters explicitly stated, was not meant to guarantee retirement income.

That courts have been so quick to find a duty to diversify for EIAPs is not surprising. In the wake of the stock market decline and attendant corporate scandals, the employer stock investments of once-celebrated EIAPs declined rapidly. Because employees depended upon these stock ownership plans for their retirement income and considered EIAPs their retirement accounts, it was perhaps difficult for courts to exempt fiduciaries completely from the duty to diversify. However, while courts may believe that this aspect of ERISA shields plan fiduciaries more than is necessary or appropriate, the courts also must apply statutes as Congress has written them. Because Congress' directives are clear in this regard, whether the enterprise is worthwhile and whether the

1985) (Scalia, J., concurring in part and dissenting in part) ("Breach of the fiduciary duty to investigate and evaluate would sustain an action to enjoin or remove the trustee . . . or perhaps even to recover trustee fees paid for the investigative and evaluative services that went unperformed. But it does not sustain an action for the damages arising from losing investments").

duty to diversify persists in spite of ERISA should not be matters for the courts to decide.