10-792-cv(L)

10-934-cv(CON)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

PATRICK L. GEARREN, on behalf of themselves and a class of persons similarly situated, JAN DEPERRY, on behalf of themselves and a class of persons similarly situated, MARY SULLIVAN, Individually and on behalf of all others similarly situated, HARVEY SULLIVAN, Individually and on behalf of all others similarly situated, CYNTHIA DAVIS, Individually and on behalf of all others similarly situated,

Plaintiffs-Appellants,

—against—

THE MCGRAW-HILL COMPANIES, INCORPORATED, THE PENSION INVESTMENT COMMITTEE OF MCGRAW-HILL, MARTY MARTIN, THE BOARD OF DIRECTORS OF THE MCGRAW-HILL COMPANIES, INCORPORATED, WINFRIED BISCHOFF, DOUGLAS N. DAFT, LINDA KOCH LORIMER, HAROLD MCGRAW, HILDA OCHOA-BRILLEMBOURG, MICHAEL RAKE, JAMES H. ROSS, EDWARD B. RUST,

(*caption continued on inside cover*)

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

AMICUS CURIAE BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF APPELLEES' REQUESTING AFFIRMANCE

Of Counsel:

IRA D. HAMMERMAN
KEVIN M. CARROLL
SECURITIES INDUSTRY AND
FINANCIAL MARKETS
ASSOCIATION
1101 New York Avenue, NW
Washington, D.C. 20005
(202) 962-7382

JOSEPH M. MCLAUGHLIN
GEORGE S. WANG
AGNÈS DUNOGUÉ
HIRAL D. MEHTA
SIMPSON THACHER & BARTLETT LLP
425 Lexington Avenue
New York, New York 10017
(212) 455-2000

Attorneys for Amicus Curiae

.

KURT L. SCHMOKE, SIDNEY TAUREL, JOHN DOES 1-20, ROBERT J. BAHASH, HENRY HIRSCHBERG, ALEX MATURRI, JAMES H. MCGRAW, IV, DAVID L. MURPHY, JOHN C. WEISENSEEL, KATHLEEN A. CORBET, PHIL EDWARDS, ROBERT J. BAHASH, PEDRO ASPE,

Defendants-Appellees.

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Amicus curiae Securities Industry and Financial Markets Association ("SIFMA") is a non-profit corporation. It has no parent corporation and no publicly held corporation owns 10% or more of its stock.

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STATEMENT OF IDENTITY AND INTEREST[1]

The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

SIFMA has an interest in this case because the issues to be decided by the Second Circuit are vitally important to the operation, and even survival, of employer stock funds as an investment alternative for 401(k) plan participants. Given the role of financial service providers in advising and creating employer stock funds for their various customers and clients, and their regular use within their own institutions, the financial services industry is uniquely concerned that Congress's longstanding encouragement of employer stock funds not be chilled by a reversal of the District Court's well-reasoned holding. SIFMA is also interested

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[1] In accordance with Federal Rule of Appellate Procedure 29(a), all parties have consented to the filing of this amicus brief. Also, in accordance with Local Rule 29.1(b), no party's counsel authored the brief in whole or in part, no party's counsel contributed money that was intended to fund preparing or submitting this brief, and no other individual or entity contributed money that was intended to fund preparing or submitting of this brief.

in this case given the widespread use of employer stock funds by its members—employers within the financial services industry.

A decision by this Court to overturn the District Court's grant of Defendants' Motion to Dismiss would run counter to the essence of employer stock funds and would threaten their very existence as a viable investment option in 401(k) plans. Plaintiffs ask this Court to impose a fiduciary duty on Plan managers to diversify or divest an employer stock fund when the employer's stock price declines, even though the Plan clearly and unambiguously requires the employer stock fund be offered as an investment alternative and even though there is no allegation that McGraw-Hill's viability was ever in jeopardy. Plaintiffs' theory of liability, if accepted, would leave Plan managers with an impossible choice. They could either (a) deviate from the Plan documents and face inevitable claims of liability for breaching their fiduciary duty to comply with the terms of the Plan instruments, or (b) adhere to the terms of the Plan documents and still face potential liability. Many employers facing such unavoidable and unsolvable risks would inevitably abandon employer stock funds. This outcome would directly undermine the well-documented congressional legislative history and various studies and surveys supporting employee stock ownership plans (ESOPs) and employer stock funds as extremely useful tools for savings and economic growth.

The District Court gave thoughtful consideration to the legal issues governing these claims, and got it right. The decision should not be disturbed on appeal.

The District Court also correctly rejected Plaintiffs' request that SEC filings be subject to challenge under the Employee Retirement Income Security Act of 1974 ("ERISA"), in addition to under the securities laws. SEC filings are subject to detailed regulation under the securities laws. Any misstatements or omissions therein are actionable as appropriate through public and private enforcement under the securities laws. To subject statements in SEC filings to duplicative regulation under the ERISA laws would create competing and potentially conflicting duties under the separate frameworks of securities and ERISA laws. It would inject rampant uncertainty into the already difficult process of preparing securities filings, and needlessly invade the province of the securities laws.

INTRODUCTION

This case arises out of claims brought by a putative class of current and former employees of Defendant The McGraw-Hill & Companies, Inc. and its Subsidiaries ("McGraw-Hill") who participated in retirement plans offered by McGraw-Hill between December 31, 2006 and December 6, 2008 (each referred to herein individually as a "Plan" and collectively as the "Plans"). (A 23, ¶ 1; A 1560, ¶ 18.) The Plans are "employee benefit plans" as defined in 29 U.S.C. §

1002(2)(A), and "eligible individual account plans" ("EIAPs"), as defined in 29 U.S.C. § 1107(d)(3). (*See* A 32, ¶¶ 30–31; A 1561–1562, ¶¶ 26–27.) An EIAP is a defined contribution plan in which employees have their own account, choose how to invest money held in that account, and bear the risk of investment gain or loss. *See* ERISA § 3(34), 29 U.S.C. § 1002(34).

Both Plans allowed participants to choose how to invest their Plan contributions. (*See* A 237, 240-41, 299, 302-03, 578-81, 881-84.) Each Plan offered thirteen investment options, including a variety of mutual funds and the McGraw-Hill Stock Fund ("Stock Fund"). (*See* A 237, 299, 579–81, 882–84; *see also* A 1562–64, ¶¶ 28, 30, 32; A 32–34, ¶¶ 32, 34, 36.)

The Plans' fiduciaries generally had discretion in selecting certain of the investment options. However, the Plan agreements *required* that the Stock Fund be offered as an investment alternative: "the Plan[s] shall offer (a) the '[McGraw-Hill] Stock Fund' which will be invested primarily in the Common Stock of the Corporation . . . ." (A 979, § 8.1; A 1119, § 8.1.) This requirement was also noted in summary plan documents ("SPDs") distributed to each Plan's participants. (A 240, 302.)

In their Complaint, Plaintiffs alleged that McGraw-Hill's financial services division, Standard & Poor's ("S&P") improperly assigned high, investment-grade ratings to a number of mortgage-backed securities and collateralized debt obligations. (A 39–40, ¶ 58; A 1569, ¶ 51.) According to Plaintiffs, "[a]s a result of Standard & Poor's improper ratings practices and other CDO and RMBS-related problems described above, and the reputational damage therefrom," the Company's stock price dropped from a peak of $68 to $24 on the last day of the alleged class period. (A 39, ¶ 57; A 51, ¶ 76; *see also* A 1569, ¶ 53; A 1581, ¶ 73.) Plaintiffs claim to have suffered losses as a result of having been invested in the Stock Fund during the class period.

Plaintiffs allege that Defendants breached their fiduciary duty by continuing to offer the Stock Fund as an investment option, even though they knew that the McGraw-Hill stock price was artificially inflated. (A 52, ¶ 82; A 1584, ¶ 86.) Plaintiffs also contend that Defendants breached their duty of disclosure by not disclosing this knowledge about the company's financial condition to Plan participants, and by making false and misleading statements in SEC filings, which were incorporated by reference into the SPDs to fulfill the requirement, under securities law, that plan participants be offered access to SEC filings provided to other potential purchasers or owners of company stock. (A 54, ¶¶ 89–91; A 1586, ¶¶ 93–95; *see also* A 223–24, 285–86.).

Defendants filed a motion to dismiss the Complaint, which was granted in its entirety by the Southern District of New York on February 10, 2010. *Gearren v. McGraw-Hill Cos.*, 690 F. Supp. 2d 254, 273 (S.D.N.Y. 2010)

(Sullivan, J.). In dismissing the Complaint, the District Court joined numerous courts in this Circuit and elsewhere holding that a presumption of prudence applies to a plan fiduciary's decision to continue to offer an employer stock fund as an investment alternative within an EIAP. As the District Court explained: "When the presumption applies, the factual allegations in the complaint must make it plausible that the defendants could not have reasonably believed that continued adherence to the terms of the plan 'was in keeping with the settlor's expectations of how a prudent trustee would operate.'" *Id.* at 270 (quoting *Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995)). The District Court held further that Plaintiffs' allegations did "not amount to the sort of catastrophic decline necessary to rebut the presumption. This is particularly true where, as here, the stock price has since rebounded to nearly $34 per share, and there is no indication that, during the class period, [McGraw-Hill's] viability as a going concern was ever threatened." *Id.* (internal citations and quotations omitted).

The District Court also dismissed Plaintiffs' disclosure claim based on alleged misstatements or omissions in SEC filings. Noting that SEC filings are, by definition, <u>not</u> made in an ERISA fiduciary capacity, the District Court held that ERISA does not impose an affirmative duty to disclose non-public information beyond that required by the securities laws. *See id.* at 271–73. The District Court noted, aptly, that requiring disclosure of non-public financial information "would either render much of securities law a dead letter, or (more likely) dissuade employers from offering company stock to employees in the first place, in direct contravention of Congress' objectives when it passed ERISA." *Id.* at 272–73.

The District Court also dismissed Plaintiffs' claims for "divided loyalty" and "failure to monitor" because they are derivative claims and Plaintiffs had failed to allege an underlying breach of fiduciary duty. *See id.* at 273.

ARGUMENT

The District Court's dismissal of the Complaint should be upheld. Defendants, as Plan fiduciaries, owed no duty to override the terms of the Plans requiring mandatory investment in the McGraw-Hill Common Stock Fund, particularly where there are no allegations suggesting McGraw-Hill's viability was ever threatened. In Point I, we provide a more comprehensive and detailed description of the purposes and legislative history of ERISA, and studies and statistics demonstrating the success of employer stock funds in order to illustrate how sustaining Plaintiffs' claims would frustrate the purposes and operation of ESOPs and employer stock funds within EIAPs. We discuss in Point II how Plaintiffs' and the Department of Labor (DOL)'s invitation to subject SEC filings to regulation under ERISA in addition to the securities laws, and create further disclosure obligations under ERISA regarding a company's business and financial condition, is untenable. Doing so would subject plan fiduciaries to conflicting statutory and regulatory imperatives, undermine the well-established and comprehensive framework of securities laws and rules, and subvert the clear congressional support for employer stock funds.

I. Employer Stock Funds Serve a Vital, Congressionally-Supported Purpose and Have Crucial Beneficial Effects

A. Purposes of Employer Stock Funds—Employee Ownership

Though ESOPs and other EIAPs that offer employer stock funds as an investment alternative are governed by ERISA, their distinct characteristics and purposes provide for certain exceptions from some of the requirements of traditional retirement plans under ERISA.[2] They are exempted from ERISA's requirement that plan assets must be diversified, and also exempted from the prohibition against self-dealing. Ezra S. Field, *Money For Nothing and Leverage For Free: The Politics and History of the Leveraged ESOP Tax Subsidy*, 97 Colum. L. Rev 743, 748 (1997); *see also* 29 U.S. §1104(2). Specifically, "the diversification requirement and the prudence requirement (only to the extent that it requires diversification) is not violated by acquisition or holding of qualifying

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2 ESOPs and employer stock funds within EIAPs both share the purpose of promoting investment in company stock. *See Edgar v. Avaya*, 503 F.3d 340, 347 (3d Cir. 2007). Thus, as to the issues presented herein, "nearly all the points made about ESOPs apply equally to EIAPs." *In re Citigroup ERISA Litig.*, No. 07 Civ. 9790, 2009 WL 2762708, at *11 (S.D.N.Y. Aug. 31, 2009).

employer securities." *Moench*, 62 F.3d at 568 (quoting 29 U.S.C. § 1104(a)(2)) (internal quotations omitted). As the Third Circuit explained:

> [U]nder normal circumstances, ESOP fiduciaries cannot be taken to task for failing to diversify investments, regardless of how prudent diversification would be under the terms of an ordinary non-ESOP pension plan. ESOPs also are exempted from ERISA's strict prohibition against dealing with a party in interest, and against self-dealing, that is, dealing with the assets of the plan in his own interest or for his own account.

Moench, 62 F.3d at 568 (citing *Martin v. Feilen*, 965 F.2d 660, 665 (8th Cir. 1992), *cert. denied*, 506 U.S. 1054 (1993) (internal quotations omitted)).

ESOPs and employer stock funds within EIAPs are exempted from the diversification requirement and the prohibition against self-dealing because the nature and purpose of employer stock funds are substantially different from that of traditional retirement plans governed by ERISA. ESOPs were designed to invest primarily in the securities of the plan's sponsoring company. *See Donovan v. Cunningham*, 716 F.2d 1455, 1458 (5th Cir. 1983), *cert. denied*, 467 U.S. 1251 (1984); *see also* 29 U.S.C. § 1107(d)(6)(A). Accordingly, "ESOPs, unlike pension plans, are not intended to guarantee retirement benefits, and indeed, by its very nature 'an ESOP places employee retirement assets at a much greater risk than does the typical diversified ERISA plan.'" *Moench*, 62 F.3d at 568 (quoting *Martin v. Feilen*, 965 F.2d at 664); *see also Edgar v. Avaya, Inc.*, 503 F.3d 340, 347 (3d. Cir. 2007); *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1094

(4th Cir. 2004) (explaining that EIAPs "place employee retirement assets at a much greater risk" than traditional ERISA plans). Moreover, ESOPs, and other EIAPs that offer employer stock funds, are intended to "encourage employee ownership of employer stock, which 'constituted a goal in and of itself' for the purpose of 'expanding the national capital base among employees-an effective merger of the roles of capitalist and worker.'" *Gearren*, 690 F. Supp. 2d at 265 (quoting *Moench*, 62 F.3d at 568) (further internal quotation marks omitted).

As the case law in this area makes abundantly clear, employer stock funds, whether offered as an ESOP or as an investment alternative within an EIAP, serve different purposes than traditional retirement plans. As will be more fully explained in the sections that follow, the purposes of employer stock funds have been consistently promoted by their legislative treatment, with an eye towards expanding the goal of employee ownership.

B. Statutory History: Consistent Support of ESOPs

Finding employee ownership of stock in their employers a laudable goal, Congress has passed numerous pieces of legislation in order to further and encourage employee ownership through ESOPs and employer stock funds in EIAPs. For instance, Congress has repeatedly shown its support of ESOPs and employer stock funds in EIAPs by offering tax and other incentives to make their establishment and maintenance both attractive and uncomplicated. Certainly, the statutes passed over the past several decades have done much in the way to expand and strengthen the original purposes and benefits of these plans.

After the passage of ERISA in 1974, it did not take long for Congress to begin passing legislation supporting the formation of ESOPs. In 1975, Congress passed the Tax Reduction Act of 1975, which gave ESOPs a corporate tax credit of 11%. *See* Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975).

The next year, Congress passed the Tax Reform Act of 1976 ("Act of 1976"), which encouraged employers to set up ESOPs. The statute itself expresses Congress' concern that the purpose of ESOPs would be frustrated if they were subject to the rules applicable to traditional retirement plans:

> The Congress is deeply concerned that the objectives sought by [the series of laws encouraging 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 the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans.

Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(h), 90 Stat. 1590 (1976), *quoted in Moench*, 62 F.3d at 569. The Tax Reform Act of 1976 amended the Internal Revenue Code to double the dollar amount that could be allocated to a participant's account in a given year. Jack Curtis & Anna Jeans, *ESOPs —A Decade of Congressional Encouragement*, 12 Tax Mgmt. Compensation Planning J. 377, 378 (1984).

In 1981, Congress again enacted legislation encouraging ESOPs and employer stock funds in EIAPs. The Economic Recovery Tax Act ("ERTA") provided a valuable tax benefit for ESOPs. *See* Economic Recovery Tax Act, Pub. L. 97-34, 95 Stat. 172 (1981). Prior to ERTA, employers making contributions to ESOPs could only deduct up to 25% of interest paid to loans made from an ESOP. *Id.*, *cited in* Robert W. Smiley, *ESOP Legislative History Summary*, *in* 2 *Employee Stock Ownership Plans*, A20-1, A20-1 (Robert W. Smiley, Jr., et al. eds., 2007). ERTA made such employer contributions fully deductible by the employer. Curtis & Jeans, *supra*, at 380.

A few years later, Congress provided a number of additional significant tax incentives for companies sponsoring ESOPs. Tax Reform Act of 1984 ("1984 Act"), Pub. L. No. 98-369, 98 Stat. 494 (1984). These tax benefits included:

> (a) A tax exclusion for commercial lenders of 50% of the interest income received on loans made to finance ESOP acquisitions of employer stock; (b) A deferral of taxation on gains from a sale of stock to an ESOP by the owner of a closely held corporation to the extent that the ESOP owns at least 30% of the common equity after the transaction and the proceeds of the sale are reinvested in securities of other U.S. operating companies; (c) A tax deduction for dividends 'passed through' in cash to ESOP participants; and (d) A provision allowing an ESOP to assume the obligation for payments of estate tax liability in exchange for stock worth at least as much as the tax liability in those situations where closely held

> company stock qualified an estate for installment payments of federal estate tax.

Smiley, *ESOP Legislative History Summary*, *supra*, at A20-2, *citing* Tax Reform Act of 1984, Pub. L. No. 98-369.

Just two years later, Congress enacted the Tax Reform Act of 1986 ("1986 Act"), which provided even further support for employer stock funds such as additional tax credits. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 383 (1986).

The consistent congressional support for ESOPs and other employer stock funds had its intended effect. ESOP participants increased from 500,000 in 1974 to ten million (across 7,000 companies) in 1986. Stephen Friedmann & Peter W. Gehnrich, *Pending Tax Legislation Will Change ESOP Rules*, Pension World, Mar. 1986, at 42.[3]

In 1996, Congress passed the Small Business Job Protection Act of 1996 ("SBJPA"). This legislation widened the availability of ESOPs by permitting S corporation shareholders to participate in ESOPs. Small Business Job Protection

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3 The Omnibus Budget Reconciliation Act of 1989 ("OBRA"), limited some of the benefits provided to ESOPs as a result of repealing and/or limiting a number of tax incentives in an effort to generate revenue during a recession. OBRA, Pub. L. No. 101-239, 103 Stat. 2106 (1989); *see also* Smiley, *ESOP Legislative History Summary*, *supra*, at A20-2. It was not long, however, before Congress once again began encouraging ESOPs through the passage of supporting legislation.

Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (1996); *see also* Fred J. Diss, *Unwinding ESOPs*, 32 Tax Mgmt. Compensation Planning J. 362, 362 (2004).

The next year, Congress passed the Taxpayer Relief Act of 1997 ("1997 Act"), providing further tax benefits for ESOPS and clarifying the provisions of the SBJPA as they related to the taxation of S corporations. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (1997); *see also* Smiley, *ESOP Legislative History Summary*, *supra*, at A20-3. The 1997 Act extended an important tax exemption to S corporation ESOPs previously available only to C corporations. *Id.* It also effectively eliminated any federal tax imposed on an S corporation's income prorated to the ESOP by allowing S corporation ESOPs to distribute cash to plan participants and repealing any business income tax on the ESOP's share of its S corporation sponsor's taxable income. *Id.*

The Economic Growth and Tax Relief Reconciliation Act of 2001 ("2001 Act"), was enacted to prevent abuse and to further encourage the creation and operation of ESOPs. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001); *see also* John A. Kober, Esq., *The New S Corporation ESOP Law*, 30 Tax Mgmt. Compensation Planning J. 36, 36 (2002).[4]

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4 The 2001 Act amended the 1996 and 1997 Acts by initiating a 50% excise tax on prohibited allocations by ESOPs sponsored by S corporations. 2001

Congress again strengthened its support of ESOPs and employer stock funds in EIAPs in the Americans Jobs Creation Act of 2004 ("Jobs Act"). Pub. L. No. 108-357, 118 Stat. 1418 (2004). The Jobs Act encouraged the formation of ESOPs in S corporations by permitting S corporations to use distributions on stock held by its ESOP to repay loans used by the ESOP to acquire stock for employees. *See* Jobs Act § 240; *see also* Press Release, The ESOP Association, The American Jobs Creation Act of 2004—A Victory for ESOPs (November 2004), *available at* http://www.esopassociation.org/pdfs/tips11_04.pdf. The Jobs Act "greatly benefits plan participants because it enables ESOPs to repay their loan amounts on a much faster basis." Smiley, *ESOP Legislative History Summary*, *supra*, at A20-4.

Act § 656(p). Additionally, a 50% excise tax was imposed on "disqualified persons," defined as individuals who own 10% of the shares, or part of a 20% shareholder group (individuals and family members collectively), owning "synthetic equity." These new taxes were "promoted by supporters of ESOPs who authored the 1996 and 1997 S corporation ESOP laws in order to further the intent of Congress to promote widespread employee ownership through ESOPs and to ensure that arrangements that did not do so would not lead to cutbacks in [other exemptions]." Smiley, *ESOP Legislative History Summary*, *supra*, at A20-3. The 2001 Act also created a dividend deduction for C corporations, expanding the provisions of the 1984 Act that allowed deductions for dividends paid on ESOP stock voluntarily reinvested in the ESOP for more company stock. 2001 Act § 662; *see also* Smiley, *ESOP Legislative History Summary*, *supra*, at A20-3. Lastly, the 2001 Act included provisions that increased the contribution limits to all defined contribution plans, including ESOPs. 2001 Act § 611 (amending I.R.C. § 415).

C. Further Support: Statistics and Studies

ESOPs and other employer stock funds in EIAPs have not only enjoyed continuous legislative support, but also academic support, through various studies and surveys. The results of these studies and surveys have consistently revealed the positive and beneficial effects of employee stock ownership for a company's growth and overall vitality. However, it is not just corporations that benefit from employee ownership. As the following studies demonstrate, employees of corporations with ESOPs or employer stock funds in EIAPs are more motivated and productive, undoubtedly due to their participation in the ownership of their employers.

In 1986, the National Center for Employee Ownership ("NCEO") published the first study to show a causal link between employee ownership and increased corporate performance. Michael Quarrey & Corey Rosen, *How Well is Employee Ownership Working*, Harv. Bus. Rev., Sept.–Oct. 1987, at 126, *cited in* Corey M. Rosen, *Employee Ownership and Corporate Performance*, *in* 1 *Employee Stock Ownership Plans*, *supra*, at 2-1, 2-2; *see also* Gerald Kalish, *ESOPs: The Handbook of Employee Stock Ownership Plans* 275 (1989).

The NCEO study examined the performance of employee ownership companies five years before and five years after they set up ESOPs, finding that "ESOP companies had sales growth rates 3.4% per year higher and employment growth rates 3.8% per year higher in the post-ESOP period than would have been expected based on pre-ESOP performance." *Id.* Significantly, the study showed a strong correlation between participative management and a company's decision to offer an ESOP, finding that the companies with the most participative management examined in the study "grew 8% to 11% per year faster than they would have been expected to grow." *Id.* As the results of the study indicated, companies with ESOPs performed better and grew at a higher rate than their competitors after establishing ESOPs. Thus, employer stock funds are good for businesses and their employees, generating increased productivity and resulting in more jobs.

Similarly, two studies—one in New York in 1992 and the other in Washington State in 1993—concluded that corporate performance increased due to the existence of ESOPs within a company, combined with participative management. Gorm Winther, *Employee Ownership: A Comparative Analysis of Growth Performance* (1995) (the "New York Study"); Gorm Winther & Richard Marens, *Participatory Democracy May Go a Long Way: Comparative Growth Performance of Employee Ownership Firms in New York and Washington States*, Economic & Industrial Democracy, Aug. 1997, at 393–422 (the "Washington Study"), *cited in* Rosen, *supra*, at 2-2 to 2-3. For example, in the Washington study, companies combining ESOPs and participative management grew in employment 10.9% per year, while sales grew 6% per year more. *Id.*

In 2000, in perhaps the largest ESOP study completed to date, researchers tracked 1,100 ESOP companies with 1,100 comparable non-ESOP companies and recorded their performance for over a decade. Joseph Blasi & Douglas Kruse, *Largest Study Yet Shows ESOPs Improve Performance and Employee Benefits* ("Rutgers Study"), *available at* http://www.nceo.org/main/article.php/id/25 (last visited July 22, 2010), *cited in* Rosen, *supra*, at 2-1 to 2-2 (2007). The Rutgers Study found that "ESOPs increase sales, employment, and sales per employee by about 2.3% to 2.4% per year over what would have been expected absent an ESOP." *Id.* The study also found that ESOP companies are more likely to stay in business than comparable companies that do not offer ESOPs. *Id.*

On August 17, 2009, the Employee Ownership Foundation released the results of its 18th annual "ESOP Economic Performance Survey" (the "Survey"). Press Release, Employee Ownership Foundation, ESOP Companies Outperform Stock Market in 2008 (Aug. 17, 2009), *available at* http://www.esopassociation.org/media/media_stock_market_outperform.asp (last visited July 22, 2010). The Survey revealed, as it has every year since the survey's creation, that an overwhelming majority of companies surveyed report that the creation of ESOPs was a "good business decision that has helped the company." *Id.* In addition, the Survey revealed that "88.5% of ESOP companies outperformed the stock market in 2008," even despite the severe economic downturn. *Id.* The President of the Employee Ownership Foundation, J. Michael Keeling, made the following remarks regarding the Survey:

> In a turbulent year, these results speak wonders for the power of employee ownership. On the other hand, this survey and most news reports show that American companies are hurting, profits are down, and layoffs are taking place across the country. Objective academic research evidences that employee owned companies are higher performing, have high employee retention rates, and have employees that are more motivated and productive. Our national leaders need to promote policies to encourage more companies to become employee owned through an ESOP to create a more fair and equitable society.

Id.

D. The Purposes and Statutory History of ESOPs, Along With Statistics and Studies, Strongly Support Affirming the District Court's Order

As is clear from the above-cited legislative history and studies, employee stock ownership plays an important role in the fabric of the American workforce, with important benefits accruing to both companies offering employer stock funds and their employees. Congress has continuously incentivized the use of employer stock funds, with the aim of making employee stock ownership easier and more attractive to establish for all types of companies, both large and small.

And as is evident from the results cited above, companies that offer employer stock funds enjoy more success, especially when combined with participative management, than those without employee ownership. Importantly, employees benefit from stock ownership in very real ways. Employer stock funds produce more satisfied and productive employees, which creates a more successful corporation, and in turn spurs job creation and overall growth.

If Plaintiffs' claims were allowed to be pursued against Defendants, companies would surely refrain from establishing and administering such plans because of the unsettled liability issues they would face. Companies would confront a "Catch 22." Requiring fiduciaries to decide either to violate the terms of a plan and divest it of employer stock when the value of the stock declines (and by what amount would be uncertain), or to adhere to plan terms despite the decline—facing potential liability no matter the decision—would place companies and their fiduciaries in an impossible situation. Faced with this insoluble problem, the only rational course would be to avoid the decision entirely and forego offering a company stock fund as an investment option.

We urge this Court to recognize the devastating effects that a reversal of the lower court's decision would have on the progression and steady growth of employer stock funds to date. Not only would such a decision undo decades of congressional support for the retirement plans, but it would also prevent companies and employees from enjoying the many benefits of employer stock funds, including enhanced performance and growth.

In order to avoid these undesirable results, this Court should uphold the District Court's holding. This is in keeping with the original purpose of employer stock funds, which, as the district court pointed out, was to "encourage employee ownership of employer stock, which 'constituted a goal [of ERISA] in and of itself' for the purpose of 'expanding the national capital base among employees—an effective merger of the roles of capitalist and worker.'" *Gearren*, 690 F. Supp. 2d at 265 (quoting *Moench*, 62 F.3d at 568) (further internal quotation marks omitted).

II. Plaintiffs' and the DOL's Theory of Disclosure Liability Improperly Seeks to Undermine the Comprehensive Securities Regulatory Framework

Plaintiffs' claim that Defendants violated the fiduciary duties imposed by ERISA by making material misrepresentations is premised entirely on alleged misstatements in SEC filings that were incorporated by reference into the Plan SPDs. (*See* Appellants' Br. at 37–43; A 54–56, at ¶¶ 91, 94; A 1586–88, at ¶¶ 95, 98.) Plaintiffs (and the DOL) also argue that fiduciaries are liable for material omissions in SEC filings, and that ERISA imposes a duty on fiduciaries to disclose non-public information to plan participants, and supplement or "correct" such SEC filings, beyond what is required by the securities laws. (*See* Appellants' Br. at 38, 43–49; DOL Br. at 22–24.)

Courts in this Circuit have repeatedly concluded that alleged misstatements and omissions in SEC filings are not actionable under ERISA because they are not made in an ERISA fiduciary capacity. *See, e.g.*, *Herrera v. Wyeth*, No. 08 Civ. 4688 (RJS), 2010 WL 1028163, at *7 (S.D.N.Y. Mar. 17, 2010); *In re Lehman Bros. Sec. & ERISA Litig.*, 683 F. Supp. 2d 294, at 300 (S.D.N.Y. 2010); *In re Citigroup ERISA Litig.*, No. 07 Civ. 9790, 2009 WL 2762708, at *22–*24 (S.D.N.Y. Aug. 31, 2009); *In re Bausch & Lomb Inc. ERISA Litig.*, No. 06-CV-6297, 2008 WL 5234281, at *7–*8 (W.D.N.Y. Dec. 12, 2008).[5] Courts in other circuits have held the same. *See, e.g.*, *In re General Growth Properties Inc.,* 08 CV 6880, 2010 WL 1840245, at *8 (N.D. Ill. May 6, 2010) (dismissing ERISA fiduciary duty of disclosure claim alleging misstatements in SEC filings); *Mellot v. ChoicePoint Inc.,* 561 F. Supp. 2d 1305, 1318 (N.D. Ga. 2007), *vacated pursuant to settlement* (May 28, 2008) (same).

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[5] The Supreme Court has explained that statements about a company's financial condition become actionable under ERISA only if they are made in a fiduciary capacity under ERISA, which occurs only if the statements are made by a plan representative and are intentionally connected to statements about a plan's benefits. *See Varity Corp. v. Howe*, 516 U.S. 489, 505 (1996).

Further, this Court has held that it would be "inappropriate to infer an unlimited disclosure obligation on the basis of [ERISA's] general provisions that say nothing about disclosure." *Bd. of Trs. of the CWA/ITU Negotiated Pension Plan v. Weinstein*, 107 F.3d 139, 146–47 (2d Cir. 1997) (citation omitted); *see also id.* at 146 (noting that "[i]n light of the precise language used by Congress ..., we see no presumption favoring disclosure to participants beyond what is required" expressly by ERISA). Indeed, the obligation under ERISA to communicate with plan participants is limited to the comprehensive disclosure requirements, expressly set forth under the statute, which cover plan administration, eligibility for plan benefits and similar information. *See In re Calpine Corp. ERISA Litig.*, No. C-03-1685 SBA, 2005 WL 1431506, at *7 (N.D. Cal. Mar. 31, 2005) (duty of disclosure under ERISA "is limited to the disclosure of information about the plan, plan benefits or plan expenses"); *see also Curtiss-Wright Corp. v. Schoonejongen*, 514 U.S. 73, 83 (1995) (noting that ERISA provides a "comprehensive set of 'reporting and disclosure' requirements" that cover plan administration, eligibility for plan benefits and similar information) (citing 29 U.S.C. §§ 1021–31)).

Compelling policy rationales underlie all of these holdings. First, securities and SEC filings are already heavily regulated by a comprehensive body of securities laws and regulations. SEC filings are, by definition, documents that directors must execute to comply with a corporation's and/or directors' obligations under federal securities laws. *See, e.g.*, 15 U.S.C. § 77f (requiring filing of registration statement with the SEC for registration of securities); 15 U.S.C. § 78m (requiring filing of various periodical and other reports with the SEC, in accordance with such rules and regulations as the SEC may prescribe). Any material misrepresentations or omissions in SEC filings are actionable under the securities laws and regulations. The securities laws and the regulations promulgated thereunder by the SEC represent a pervasive regulatory scheme. *See Feins v. American Stock Exchange, Inc.*, 81 F.3d 1215, 1221 (2d Cir. 1996) ("The Exchange Act sets out a comprehensive regulatory scheme for the securities industry."). A plethora of rules, regulations, SEC no-action letters and case law provides guidance on obligations under the securities laws.

The SEC, acting pursuant to specific congressional directives, actively regulates securities transactions generally, including securities transactions made by or through employee benefit plans. The Securities Act of 1933 and the Securities Exchange Act of 1934 grant the SEC nearly plenary authority to regulate the purchase and sale of securities in the United States, including those made by employee benefit plans. 15 U.S.C. §77a, *et seq.* Thus, to subject SEC filings to duplicative and conflicting regulation under ERISA would be unworkable. As the District Court rightly noted, such an approach would "render much of securities law a dead letter." *Gearren*, 690 F. Supp. 2d at 273. Holding Defendants liable under ERISA for SEC filings deemed adequate under the securities laws would subject companies to conflicting statutory and regulatory imperatives and undermine the well-established and comprehensive framework of securities laws and rules that provides predictability to issues of securities and their management. Such an interpretation cannot be accepted.

Indeed, to permit these thinly disguised securities cases to proceed as ERISA suits would endorse an end run around every rule of pleading, proof, damages, and procedure that Congress, the Supreme Court and this Court have deemed important in private securities actions. The result would heavily burden the federal courts as plaintiffs file more and more ERISA claims. If the securities law issues underlying Plaintiffs' ERISA suits were litigated in a securities case, they would be adjudicated under established laws that Plaintiffs seek to bypass.[6] The Supreme Court has imposed limitations on private securities fraud actions because they present "a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 739–740 (1975). It has interpreted the securities laws to require proof of loss causation (*Dura Pharm., Inc. v. Broudo*, 544 U.S. 336,

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6 In fact, the allegedly inaccurate disclosures in the securities filings are the subject of a securities-based lawsuit pending before a different judge in the Southern District of New York. *See Reese v. Bahash*, 08 Civ. 7202 (SHS) (S.D.N.Y.).

341–346 (2005)) and proof of scienter rather than mere negligence (*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)), rejected a lax definition of materiality (*TSC Indus. v. Northway, Inc.*, 426 U.S. 438 (1976)), limited the definition of actionable manipulation (*Santa Fe Indus. v. Green*, 430 U.S. 462 (1977)), and barred private aiding and abetting claims. *Central Bank v. First Interstate Bank*, 511 U.S. 164, 188–190 (1994). Plaintiffs seek to vault over all these safeguards simply by re-labeling their securities claims as ERISA claims. Congress has also imposed constraints designed to curb "abuses of the class-action vehicle in litigation involving nationally traded securities," including the extraction of "extortionate settlements." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006). The PSLRA requires specific pleading of securities fraud, limits the maintenance of class actions, and withholds discovery pending resolution of dismissal issues. 15 U.S.C. §§ 78u-4(b)(1), (2) (requiring particularized pleading), § 78u-4(a) (special procedural requirements for class actions), §§ 78u-4(b)(3), 77z-1(b) (discovery stay). And because joint and several liability coerces innocent parties to settle rather than risk liability for a disproportionate share of the damages, the PSLRA mandates proportionate liability where the defendant did not knowingly violate the securities laws. *Id.* § 78u-4(f).[7]

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[7] When securities plaintiffs tried to avoid the PSLRA's obstacles by filing state-law class actions in state court, Congress closed that loophole by

Second, Plaintiffs' theories, if accepted, would seem to require that companies disclose to employees certain corporate information not disclosed to others, thus encouraging or facilitating conduct that would violate insider-trading prohibitions. Such an interpretation of what ERISA permits, or indeed requires, is implausible on its face. The federal securities laws require that "anyone in possession of material inside information must either disclose it to the investing public, or … abstain from trading in or recommending the securities concerned while such inside information remains undisclosed." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 848 (2d Cir. 1968) (en banc); *see also* SEC Release Nos. 33-7881 and 34-43154, at pt. III(A)(2) (Final Rule on Selective Disclosure and Insider Trading), 2000 SEC LEXIS 1672 (Aug. 15, 2000); 17 C.F.R. § 243.100 (SEC Regulation FD, prohibiting the selective disclosure of material, non-public information).

Requiring that fiduciaries disclose material non-public information to plan participants would obligate fiduciaries to run afoul of this "disclose (to the public) or abstain" rule—and, as the District Court astutely recognized here, would "facilitat[e] systemic insider trading." *Gearren*, 690 F. Supp. 2d at 273. Similarly,

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enacting the Securities Litigation Uniform Standards Act (SLUSA), and the Supreme Court subsequently rejected a "narrow reading" of SLUSA that did not cover holder suits because it "would undercut the effectiveness of the [PSLRA]," contrary to Congress's clear purposes. *Dabit*, 547 U.S. at 86.

requiring—as the DOL suggests in its amicus brief—that fiduciaries eliminate company stock as an option under EIAPS on the basis of material non-public information (DOL Br. at 27) would also expose fiduciaries to liability for violating this rule. Informing plan participants of the elimination of a company stock fund would be tantamount to disclosing non-public material information to this sub-set of investors; furthermore, it would likely also require that the fiduciaries direct the plans to sell company stock, thus contravening the directive to abstain from trading on inside information.[8] The DOL's alternative proposal that plan fiduciaries instead be required to make a disclosure to "other shareholders and the public at large," rather than just plan participants (DOL Br. at 26), finds no support in the ERISA statute and simply disregards the existing framework of securities laws and regulations concerning insider trading by seeking to take away the existing option to "abstain" from trading on inside information.[9]

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8 *See Kirschbaum v. Reliant Energy*, 526 F.3d 243, 256 (5th Cir. 2008) ("[I]n some cases, requiring a fiduciary to override the terms of a company stock purchase plan could suggest the necessity of trading on insider information. Such a course is prohibited by the securities laws."); *Harzewski v. Guidant Corp.*, 489 F.3d 799, 808 (7th Cir. 2007) ("It probably would have been unlawful . . . for [Defendant] to sell the [company] stock held by the pension plan on the basis of inside knowledge about the company's problems.").

9 Similarly, the DOL's suggestion that plan fiduciaries could also fulfill purported ERISA disclosure obligations by alerting regulatory agencies, such as the SEC and the DOL, to misstatements in SEC filings (DOL Br. at

Finally, Plaintiffs' (and the DOL's) theories of liability under ERISA would undermine the clear congressional support for employee stock funds detailed above. As correctly noted by the District Court, Plaintiffs' suggestion that "when a company offers its stock to employees, its disclosure obligations, as to all current and potential investors, are governed by ERISA rather than securities law … would either render much of securities law a dead letter, or (more likely) dissuade employers from offering company stock to employees in the first place, in direct contravention of Congress's objectives when it passed ERISA." *Gearren*, 690 F. Supp. 2d at 273. Rather than submit to expanded and contradictory requirements and liabilities in connection with any statements made concerning its business, financial condition and stock, a company would likely forebear from offering employer stock funds as part of its EIAPs. Plaintiffs' interpretation of ERISA therefore runs counter to the consistently expressed congressional purpose of encouraging employee ownership and all of the beneficial effects of employer stock funds discussed at length herein.

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27) is inherently inconsistent with the existing securities regulatory framework.

CONCLUSION

For all of the foregoing reasons, we urge this Court to affirm the decision of the District Court and dismiss the Complaint in its entirety.

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Respectfully submitted,

SIMPSON THACHER & BARTLETT LLP

By: Joseph M. McLaughlin

Joseph M. McLaughlin
(jmclaughlin@stblaw.com)
George S. Wang
(gwang@stblaw.com)
Agnès Dunogué
(adunogue@stblaw.com)
Hiral D. Mehta
(hmehta@stblaw.com)
425 Lexington Avenue
New York, NY 10017-3954
(212) 455-2000

Attorneys for Amicus Curiae Securities Industry And Financial Markets Association

CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. 32(a)(7)(B) and Fed. R. App. 29(d) because it contains 6,910 words, excluding the parts of the brief exempted by Fed. R. App. 32(a)(7)(B)(iii). This brief complies with the typeface requirements of Fed. R. App. 32(a)(5) and the type style requirements of Fed. R. App. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2007 in Times New Roman size 14-point font.

Dated: July 22, 2010

Respectfully submitted,

SIMPSON THACHER & BARTLETT LLP

By: Joseph M. McLaughlin

Joseph M. McLaughlin
(jmclaughlin@stblaw.com)
George S. Wang
(gwang@stblaw.com)
Agnès Dunogué
(adunogue@stblaw.com)
Hiral D. Mehta
(hmehta@stblaw.com)
425 Lexington Avenue
New York, NY 10017-3954
(212) 455-2000

Attorneys for Amicus Curiae Securities Industry And Financial Markets Association