No. 18-20379

IN THE

United States Court of Appeals for the Fifth Circuit

JEFFERY SCHWEITZER; JONATHAN SAPP;
RAUL RAMOS; DONALD FOWLER,

Plaintiffs-Appellants,

v.

THE INVESTMENT COMMITTEE OF THE PHILLIPS 66
SAVINGS PLAN; SAM FARACE; JOHN DOES 1-10, INCLUSIVE,

Defendants-Appellees.

On Appeal from the United States District Court
For the Southern District of Texas at Houston
Civil Case No. H-17-3013,
Honorable Sim T. Lake, III

REPLY BRIEF OF APPELLANTS

ROBERT A. IZARD
MARK P. KINDALL
DOUGLAS P. NEEDHAM
IZARD KINDALL & RAABE LLP
29 South Main St., Suite 305
West Hartford, CT 06107
860-493-6292

THOMAS R. AJAMIE
JOHN S. EDWARDS, JR.
AJAMIE LLP
711 Louisiana, Suite 2150
Houston, TX 77002
713-860-1600

TILLMAN J. BRECKENRIDGE
GREGORY Y. PORTER
MARK G. BOYKO
BAILEY & GLASSER LLP
1054 31st St., NW, Suite 230
Washington, D.C. 20007
202-463-2101
tbreckenridge@baileyglasser.com

Counsel for Plaintiffs-Appellants

CERTIFICATE OF INTERESTED PERSONS

Case No. 18-20379; JEFFERY SCHWEITZER; JONATHAN SAPP; PAUL RAMOS; DONALD FOWLER, Plaintiffs-Appellants, v. THE INVESTMENT COMMITTEE OF THE PHILLIPS 66 SAVINGS PLAN; SAM FARACE; JOHN DOES 1-10, INCLUSIVE, Defendants-Appellees.

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

- Jeffery Schweitzer, Jonathan Sapp, Paul Ramos, and Donald Fowler – Plaintiffs/Appellants;
- Tillman J. Breckenridge, Gregory Y. Porter, Mark G. Boyko, Bailey & Glasser LLP—Attorneys for Plaintiffs/Appellants and Interim Co-Lead Class Counsel;
- Robert A. Izard, Mark P. Kindall, Douglas P. Needham, Izard Kindall & Raabe LLP—Attorneys for Plaintiffs/Appellants and Interim Co-Lead Class Counsel;
- Thomas R. Ajamie, John S. "Jack" Edwards, Jr., Ajamie LLP—Counsel for Plaintiffs/Appellants and Interim Liaison Class Counsel;
- Zam Atiram—Plaintiff;
- Michael Klein, Stull, Stull & Brody—Counsel for Plaintiff Zam Atiram;
- The Investment Committee of the Phillips 66 Savings Plan, Sam Farace—Defendants/Appellees;
- Travis J. Sales, Michael B. Bennett, Tina Q. Nguyen, Aaron Michael Streett, Baker Botts L.L.P.—Attorneys for Defendants/Appellees.

/s/ Tillman J. Breckenridge
Tillman J. Breckenridge

Attorney of record for
Plaintiffs/Appellants

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SUMMARY OF ARGUMENT

Defendants' protestations that their actions were prudent are particularly unwarranted because they do not come after discovery, presentation of evidence, and a factfinder's determination that their actions were, in fact, prudent. As the Opening Brief repeatedly notes, the district court erroneously ruled *as a matter of law* that Defendants' actions were not imprudent. The vast majority of Defendants' responsive brief argues that a non-employer single-stock fund is inherently prudent. Indeed, holding as much is the only way to affirm the district court. But Defendants do not, and cannot, carry that burden.

The Court need not find that retaining the fund was inherently *im*prudent to reverse and remand. But Judge Wilkinson recognized in *Tatum v. RJR Pension Investment Committee*, quoting the Supreme Court's language in *Fifth Third Bancorp v. Dudenhoeffer*, that retaining a single-stock fund *is* inherently imprudent. So, it certainly is plausible that it was imprudent to retain this single-stock non-employer fund, and the Court need only hold that the allegation is plausible for reversal to be appropriate.

Defendants do not address, let alone combat, the Opening Brief's discussion establishing that the Supreme Court in *Tibble v. Edison International* required fiduciaries to divest an imprudent investment option even if all other options were prudent, and in *Fifth Third Bancorp v. Dudenhoeffer*, the Supreme Court required pleading special circumstances affecting a stock's price *only* if the plaintiff asserts that the fiduciary over- or under-valued publicly traded employer stock—that is it bought too high or sold too low. Plaintiffs here do not allege that the Plan overpaid or underpaid for stock. Rather, the case is based on an allegation that, under the circumstances, a reasonable trier of fact could find that retaining a giant single-stock non-employer fund was imprudent. *Dudenhoeffer*'s special circumstances pleading requirement is inapplicable here.

This appeal comes down to Defendants' assertion, endorsed and relied on by the district court, that they have no obligation to ensure that each and every investment option is prudent, so long as they provide a plan with diverse options for participants. If that were true, the mandate from *Tibble* that Defendants claim to agree with—the duty to monitor investments and

remove imprudent ones—would be meaningless. If defendants offered a seafood buffet that included toxic oysters, it would be no defense to argue that customers had the option of selecting non-toxic shrimp and crab legs. Thus, the question is whether a reasonable factfinder could find that Defendants breached the duty of prudence by failing to monitor each individual fund and failing to remove an imprudent one. The Supreme Court answered this question, and the district court's decision should be reversed.

ARGUMENT

I. Plaintiffs adequately pled that Defendants' retention of the ConocoPhillips single-stock funds was imprudent.

A. Defendants violated the duty to diversify at the fund level under 29 U.S.C. § 1104(a)(1)(B).

The parties dispute whether there is a duty to diversify at all under 29 U.S.C. § 1104(a)(1)(B), and also whether there is a duty to diversify individual funds. Section 1104(a)(1)(B) states that "a fiduciary shall discharge his duties with respect to a plan . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity . . . would use." "Diversification is fundamental to

the management of risk and is therefore a pervasive consideration in prudent investment management." Restatement (Third) of Trusts § 227, comment f (1992). Thus, it is unsurprising that this Court (1) stated that there "may" be a duty to consider diversification of an investment within a portfolio, (2) noted that it would address the possibility later in the opinion, and (3) *held* that the defendant violated the duty of care subsumed in the duty of prudence by *not* considering the investment's diversification. *Bussian v. R.J.R. Nabisco, Inc.*, 223 F.3d 286, 294 & 300 (5th Cir. 2000). Accordingly, the Court recognized both a diversification duty under Section 1104(a)(1)(B) and that the duty applies to investments within a plan. *Id*.

Whether a fiduciary acted imprudently by failing to diversify an individual fund within a plan is an issue of fact. Here, if Plaintiffs are provided the opportunity for discovery and trial, expert testimony will establish that the ConocoPhillips single-stock funds were imprudent for this reason.

To claim that their conduct was prudent as a matter of law, Defendants' primarily argue that the text of Section 1104(a)(1)(B) does not

use the word "diversify." But the duty of prudence encompasses many duties that are not expressly enumerated. For example, in *Bussian*, the Court held that the duty of prudence in 29 U.S.C. § 1104(a)(1) includes duties of loyalty and care. 223 F.3d at 299-300. The word "loyalty" does not appear anywhere in Section 1104(a)(1). Similarly, the parties agree that there is a duty to monitor investments. *See* Appellees' Br. 2. But the word "monitor" does not appear in Section 1104(a)(1) either. Accordingly, the duty of prudence encompasses many duties that are not expressly listed, including the duty to diversify.

Section 1104(a)(2) confirms this fact. It states that, for eligible individual account plans, "the diversification requirement of paragraph (1)(C) and the prudence requirement (*only to the extent it requires diversification*) of paragraph (1)(B) is not violated by" holding employer securities (emphasis added). Plainly, the statute (and Congress) treats diversification as a component of prudence; otherwise the emphasized parenthetical would make no sense. Equally plainly, no security other than employer securities are exempt from the duty to diversify. It is careless to

engage in Defendants' behavior, and thus a breach of the duty of care, to simply transfer such a large single-stock securities fund to a plan where it is no longer an employer security. ROA.34.

Defendants further claim the duty does not exist because of the plan-specific provision in Section 1104(a)(1)(C). Appellees' Br. 25-26. But Section 1104(a)(1)(C) does more than simply state a duty to diversify—it establishes a presumption that failing to diversify the plan as a whole is imprudent. All of Section 1104(a) is part of the "prudent man standard of care." So, there is no reason that the more specific statement creating an express presumption should eliminate the broader diversification requirements for prudence. Those duties are not excised from the requirement of prudence in Section 1104(a)(1)(B); they just do not benefit from the presumption. And the Court has correctly "recognized that [Section 1104(a)(1)] imposes several overlapping duties." *Bussian*, 223 F.3d at 294.

Nor are Defendants absolved from their duties by the fact that participants could have withdrawn their assets from the ConocoPhillips single-stock funds. Defendants say they just want to be "responsible for the

decisions *they* are charged with making." Appellees' Br. 15. Plaintiffs agree. Defendants should be held responsible for their decisions to offer two undiversified non-employer single-stock funds and to keep a third of Plan assets invested in those funds. Defendants agree that the Supreme Court expressed a duty in *Tibble v. Edison International*, 135 S. Ct. 1823, 1828-29 (2015), for fiduciaries to continuously monitor investment options and remove imprudent ones. Appellees' Br. 2. Yet their position is antithetical to that duty—they claim that they are absolved from claims that they imprudently decided to keep the ConocoPhillips single-stock funds simply because participants could have chosen not to retain that stock or because they offered a diverse array of investment options. Appellees' Br. 15. But that is true with every plan investment option, and if Defendants' position was correct, then *Tibble* would be wrong.

This Court and others have recognized the fiduciary duty to ensure that each fund is a prudent investment option. *See* Opening Br. 14-15, *citing Langbecker v. Electronic Data Sys.*, 476 F.3d 299, 308 n.18 (5th Cir. 2007), *Hecker v. Deere & Co.*, 569 F.3d 708, 711 (7th Cir. 2009), and *DiFelice v. U.S. Airways,*

Inc., 497 F.3d 410, 414 (4th Cir. 2007). Defendants attempt to distinguish these cases based on their failure to state that Defendants had a specific duty to *diversify* each individual fund. Appellees' Br. 14-16. But Defendants ignore the proposition for which Plaintiff cited the cases: *Langbecker*, *Hecker*, and *DiFelice* place a duty on fiduciaries not to simply provide options—some prudent and some imprudent—and then leave participants on their own. All investment options must be prudent. Opening Br. 15. The fact that these cases do not specifically mention the word "diversify" does not in any way limit the scope of the duty of prudence. To the contrary, *DiFelice* specifically noted that "*any* single stock fund carries significant risk, and so would seem generally imprudent under ERISA." 497 F3d. at 424. Moreover, the participants in these plans are not retirement investment experts. They rely on their fiduciaries to provide them a menu of only *prudent* investment options.

To underscore their theory that they do not have a duty to ensure that each fund is a prudent, diversified investment, Defendants mischaracterize the history of the *Tatum* case cited in the Opening Brief. Appellees' Br. 28.

In *Tatum v. RJR Pension Investment Committee*, participants challenged fiduciaries' decision to divest a former ESOP fund after a spin off. 761 F.3d 346, 351 (4th Cir. 2014) ("*Tatum IV*"). After a bench trial, the district court found a breach of procedural prudence, but also determined that "'a reasonable and prudent fiduciary *could* have made [the same decision] after performing [a proper investigation].'" *Id.* (quoting district court).

The Fourth Circuit held that the proper question was what a prudent fiduciary *would* have done, rather than what it *could* have done. *Id*. at 365. The court then instructed the district court, on remand, to determine what a reasonable fiduciary would have done, and held that it was neither per se prudent nor imprudent to divest the fund. *Id*. at 368. The court recognized that the district court could determine, based on the evidence, that a prudent fiduciary would have divested. *Id*. Or it could determine, based on the stock price falling—a fact not present here—that "freezing the Funds had already mitigated the risk and . . . divesting the shares *after* they declined in value would amount to 'selling low.'" *Id*. The Fourth Circuit certainly did not

suggest that the district court could appropriately hold, without any discovery or trial, that it was inherently prudent *not* to divest the fund.

In dissent, Judge Wilkinson argued that the court should have simply recognized the objective reasonableness of divesting the fund because "ERISA is, first and foremost, meant to protect plan participants from large, unexpected losses, including those that result from holding undiversified single-stock non-employer funds." *Id*. at 373 (Wilkinson, J. dissenting). He then provided clear reasoning to support his statements that "[a]lthough ERISA does not in so many words require every fund in an investment plan to be fully diversified, each fund, when considered individually must be prudent," and "single-stock funds inherently 'are *not* prudently diversified.'" *Id*. at 380, quoting *Dudenhoeffer*, 134 S. Ct. at 2465.

On remand, after evaluating the evidence presented at trial, the district court ruled that it was prudent to divest the single-stock fund. That plan "included not one single-stock fund, but three single-stock funds, two of them were non-employer single-stock funds." *Tatum v. R.J. Reynolds Tobacco Co.*, No. 02CV00373, 2016 WL 660902, at *13 (W.D.N.C. Feb. 18, 2016) ("*Tatum*

V"). "In contrast, of approximately 10,000 participant directed funds, none maintained active non-employer single-stock options" and "[t]he parties identified only twelve circumstances in which 401(k) plans maintained frozen non-employer stock funds, nine of which occurred prior to January 31, 2000." *Id*. And because the fund resulted from a spin-off, there was idiosyncratic risk due to the correlation between the non-employer single-stock fund and the ESOP. *Id*. Based on the evidence presented, the court ruled that the defendant met its burden of proving that "it is more likely true than not that had a prudent fiduciary reviewed the information available to it at the time . . . it would have decided to divest the Nabisco Funds at the time and in the manner as did RJR." *Id*. at *23.

The evidence in *Tatum* included expert testimony from both sides on "the decision that a prudent fiduciary would have made about the frozen Nabisco Funds." *Id*. at *12. It further included evidence on the nature of the funds and the practices of similar funds. *Id*. at *13. There was evidence about the correlation between the former employer's stock and the current employer's stock, and on the effect of that correlation on the prudence of

retaining the single-stock fund. *Id*. The parties also presented testimony and evidence on the effect that industry trends—in that case, the tobacco industry—had on the prudence of diversifying the former-employer single-stock fund. The court allowed discovery, received evidence, and resolved the case.

The Fourth Circuit affirmed the district court's judgment. *Tatum v. RJR Pension Inv. Comm.*, 855 F.3d 553, 556 (4th Cir. 2017) ("*Tatum VI*"). As discussed in more detail below, the Court stated in *Tatum VI* that "a prudent fiduciary would have balanced the increased risk of loss that the Nabisco Funds brought to the Plan—risk reflected in the low stock price, but also the risk inherent in their lack of diversity within the plan and the Nabisco stock's high correlation with RJR's battered stock—against the Funds' likely *average* returns." *Id*. The same is true here. Since ConocoPhillips was a large, publicly traded stock in an efficient market, there was *no* reason for Defendants to expect above average returns and *no* justification for the increased risk of an undiversified single-stock fund.

For the same reasons, modern portfolio theory does not absolve Defendants of liability for failing to diversify. To the contrary, since Conoco Phillips was widely traded in an efficient market, modern portfolio theory demonstrates that it was properly priced and could not be expected to outperform market expectations sufficient to justify the Funds' "excessive" risks resulting from a lack of diversification.

Defendants cite regulations suggesting that fiduciaries must evaluate investments in the context of a plan as a whole apparently to support an argument that an individual fund can never be imprudent. But the regulations only underscore the fact-intensive nature of an inquiry into fiduciary diligence. That is evident from the case Defendants rely on: *Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313 (5th Cir. 1999). Appellees' Br. 30-31. There, the Court reversed the district court's judgment made *after trial* because the court did not properly consider evidence of the fund's value as part of the portfolio. *Laborers Nat'l*, 173 F.3d at 315. The Court relied heavily on the evidence of

process and propriety of the investment adduced *at trial*. *Id.*, at 320-22. Modern portfolio theory does not justify dismissing this action.

The Complaint alleges that it was imprudent to retain giant single-stock non-employer funds—particularly ones that were highly correlated with another single-stock fund in the portfolio. ROA.12. If, at trial, Defendants can establish that this was prudent in the context of a defined contribution 401(k) portfolio, then they should do so. But Plaintiffs are equally entitled to present contrary evidence, at trial and after completing fact and expert discovery, demonstrating imprudence.

Defendants take offense at the Opening Brief's discussion of the stock price at various points. Appellees' Br. 11, 31. Contrary to Defendants' argument, Plaintiffs are not arguing that Defendants should have immediately sold all ConocoPhillips stock. The question, per *Tatum IV*, is a factual one: what would a prudent fiduciary have done. In *Tatum V*, the district court deemed a six-month divestment period prudent after reviewing the evidence. 2016 WL 660902, at *13. In this case, the proper divestment period may be different. That is why Plaintiffs are entitled to

discovery and a trial with expert testimony to explain to the factfinder how and when a prudent fiduciary would have gone about diversifying the Plan, and a calculation of damages to determine how much the Plan lost from Defendants' continuing to ride that stock. Defendants' attempt to prove their case here, before discovery and without a trial, only proves the need to move forward with gathering evidence and a full and fair presentation by both sides to the factfinder.

Here, Plaintiffs have been denied the opportunity to discover that evidence or present any of it at trial. Defendants' theory here rests on the assumption that failure to ensure that each fund is diversified cannot be imprudent as a matter of law. The Fourth Circuit squarely rejected that in *Tatum IV*, 761 F.3d at 365, and on remand, the district court clarified, after hearing the relevant evidence, that it was *im*prudent to keep a large single-stock fund of a *former* employer's stock, *Tatum V*, 2016 WL 660902, at *13.

Non-employer single-stock funds in this context are inherently imprudent, but the Court need not reach that question here. It is enough to recognize that Plaintiffs have at least pled a plausible claim that it was

imprudent for Defendants to retain the single-stock ConocoPhillips funds. And Defendants have provided no reasonable support for the district court's finding—before Plaintiffs have even had the opportunity for any discovery—that, as a matter of law, Defendants' conduct was prudent.

At bottom, Defendants' sky-is-falling arguments about applying the duty to diversify at the fund level ignores that the district court dismissed this case before it got started. Nothing in Plaintiffs' claims would compel the conclusion that bond funds or real estate investment trusts are necessarily imprudent. Plaintiffs always have the burden to prove both a lack of diversification and the imprudence of failing to diversify in context (unlike the burden shifting on prudence at the plan level). However, Plaintiffs are only required to meet that burden at trial, after discovery, not at the pleadings stage. Plaintiffs adequately pled that the ConocoPhillips funds were not diversified, and it was thus imprudent to have them in the context of the portfolio. That is all that is required at this stage of the case.

B. Defendants violated the duty to diversify the Plan under 29 U.S.C. § 1104(a)(1)(C).

The Opening Brief establishes that the Complaint plausibly pleads that Defendants violated Section 1104(a)(1)(C) because the Plan as a whole was not diversified. Opening Br. 20-24. A year-and-a-half after the spin-off, more than a quarter of the Plan's assets were still in the ConocoPhillips single-stock funds. That alone creates a triable issue of fact on whether Defendants properly diversified the Plan. The Opening Brief notes how a district court found a plan not diversified "on its face" when it had a 23% concentration in one investment, how no other investor held even close to the concentration of ConocoPhillips stock that the Plan had, and how the highest concentration among "diversified" funds is only 0.4%. Opening Br. 21.

Defendants acknowledge that Section 1104(a)(1)(C) requires diversification of the plan as a whole, but then assert that a plan is adequately diversified if it offers a menu of investment options, regardless of concentration of investments within the plan. Appellees' Br. 18-24. Defendants double down on the district court's reliance on *Yates v. Nichols*,

286 F.Supp.3d 854, 864 (N.D. Ohio 2017). Appellees' Br. 20. The court in *Yates* simply speculated, citing no authority, that "all [fiduciaries] can do, it would seem, is offer a diversified menu of investment options." *Id.* This speculation is contrary to *Tibble's* command to divest imprudent funds, as well as the *Tatum* cases, which demonstrate that fiduciaries *can* divest from giant single-stock funds. Moreover, the district court's reliance on *Yates* ignores that the fiduciaries here have divested funds in this plan before. ROA.21. Thus, providing a "diversified menu of options" is clearly *not* all that the Plan's fiduciaries can do; they can and have utilized divestment as a tool to manage investments.

In addition to being contrary to *Tibble*, the district court's determination that Defendants are only required to provide a diversified menu contravenes the plain text of Section 1104(a)(1)(C), which requires diversification of "the investments" themselves, not "the investment menu." 29 U.S.C. § 1104(a)(1)(C). Diversification is required "so as to minimize the risk of large losses." *Id*. Simply offering options and leaving participants to

their own devices does nothing to minimize the risk of large losses *to the plan*, on whose behalf this suit is brought.

Moreover, Defendants' claim that "Phillips 66 Plan participants, not the Fiduciaries, decided how assets would be allocated among the plan's available investment options" is simply wrong. Appellees' Br. 21. Participants did not choose to allocate such a great percentage of the Plan to a non-employer single-stock fund. Defendants made that decision when they transferred the former employer securities into the new plan with no plan for an orderly and expeditious divestment.

Indeed, in *Tatum VI*, the Fourth Circuit rejected this argument that divestment should be treated differently from investment. *Tatum*, 855 F.3d at 561. There is no higher burden to justify divestment decisions, and no presumption against divestment in ERISA. *Id*. Moreover, in *Tatum V*, the district court noted that non-employer single-stock funds are extremely rare in defined contribution plans. 2016 WL 660902, at *13. So Defendants' concerns about hamstrung fiduciaries who have no choice but to offer non-diversified funds are specious at best. Nor does Plaintiffs' argument require

"micro-manage[ment of] participants' investments," Appellees' Br. 24. But as noted by the Supreme Court in *Tibble* and numerous other cases, fiduciaries cannot simply make investments and forget about them. They must monitor the funds and remove imprudent ones.

29 U.S.C. § 1025 does not suggest otherwise. *See* Appellees' Br. 29. Of course single-stock funds are permitted—when they are ESOPs—and the required statement suggesting to participants that they not invest more than 20% of their portfolios in "employer securities" does not amount to congressional approval of large non-employer single-stock funds. *See DiFelice*, 497 F.3d at 424, (Congress made exception only for employer stock funds). Similarly, the Supreme Court has noted that "single-stock funds inherently 'are *not* prudently diversified.'" *Tatum IV*, 761 F.3d at 380 (Wilkinson, J. dissenting), *quoting Dudenhoeffer*, 134 S. Ct. at 2465.

No one is asking Defendants to become the participants' personal financial advisors, and no one is asking them to do anything they cannot do. Thus, the authorities Defendants cited to the district court about allowing participants freedom to choose from a menu of funds are irrelevant.

Appellees' Br. 24. This suit alleges that Defendants breached their statutory duty to diversify the Plan. A prudent fiduciary allows participants to choose from a diversified menu of *prudent* investment options. To the extent defendants claim they are absolved because they run a defined contribution plan where individuals make their own allocation decisions, they claim an exemption for all defined contribution plans that does not exist in the statute.

C. *Dudenhoeffer* establishes Defendants' *im*prudence.

The Supreme Court did not eliminate the duty of prudence for all publicly traded investments in *Dudenhoeffer*. 134 S. Ct. 2459. Defendants' only attempt to justify the district court's mis-application of *Dudenhoeffer* here is to again mis-characterize Plaintiffs' claims as dependent on a non-existent allegation that fiduciaries over-valued the stock. Appellees' Br. 41. The Opening Brief was clear that *Dudenhoeffer* only requires pleading special circumstances that would affect the market price when asserting that a fiduciary has over-valued employer stock by relying on the market price, such as, for example, trading in an inefficient market. Opening Br. 26. But it does not abrogate the duty of prudence. Opening Br. 26-27. The duty to

diversify remains because the market price does not include concentration risk. Opening Br. 27. Assuming the efficiency of the market—an assumption the Supreme Court relied on in *Dudenhoeffer*—there is no reason for a fund to encourage participants to retain large amounts of investment in just one non-employer company. Opening Br. 27-28.

Dudenhoeffer did not establish a general rule against relying on public information to establish imprudence. In *Tatum VI*, the Fourth Circuit fully addressed *Dudenhoeffer's* role in prudent evaluation of a former-employer securities fund after a spin-off. 855 F.3d at 566. Specifically, *Dudenhoeffer* does not absolve a fiduciary who causes a plan to offer an undiversified non-employer stock fund that is properly priced by the market because the excessive risk of that fund cannot be justified by the expected market returns.

Here, the Opening Brief established that the public information relied on in the Complaint does not undermine the market price. Opening Br. 24-29. Instead, public information showed Defendants *should have* relied on the market price of ConocoPhillips stock. Since there was no reason to believe that the stock was undervalued, there was no reason to expect extraordinary

returns that might justify the extraordinary risk of an undiversified investment. To use the language of modern portfolio theory, the ConocoPhillips stock fund presented massive uncompensated risk.

Rather than address the imprudence of this uncompensated risk, Defendants wrongly suggest that Plaintiffs claim Defendants should not have relied on the market price of the stock. Appellees' Br. 41 ("Contrary to Appellants' allegations, fiduciaries 'may, as a general matter, . . . prudently rely on the market price' of a stock, as fiduciaries are unlikely to outperform the market 'based solely on their analysis of publicly available information.'"). They do not respond at all to the Opening Brief explaining that the Complaint does not even suggest that the market over- or under-valued the stock or that Defendants acted imprudently by relying on the market price.

II. Plaintiffs adequately alleged Defendants' failure to investigate.

With respect to allegations of the failure to investigate, Defendants do not engage the arguments advanced in the Opening Brief. Instead, Defendants again misstate the contents of the Opening Brief. They claim

that Plaintiffs assert that "because the Plan contained a lot of ConocoPhillips stock, and because the stock-price declined at some point, the Fiduciaries must have failed to engage in an adequate process to monitor the Plan's investments." Appellees' Br. 43-44. This is flatly untrue.

The Opening Brief described the appropriate pleading standards for evaluating the Complaint. Opening Br. 29-34. It discussed how only Defendants have specific information on what form their investigation took, and several courts, including this one, have held that plaintiff is not required to plead information that is naturally in Defendants' control. *See* Opening Br. 34, citing *Innova Hosp. San Antonio, L.P. v. Blue Cross & Blue Shield of Ga., Inc.*, 892 F.3d 719, 728-29 (5th Cir. 2018). Other circuits apply that principle in ERISA cases, given the amount of information fiduciaries have about their own investigation that they do not readily provide to plaintiffs outside of discovery. *Allen v. GreatBanc Trust Co.*, 835 F.3d 670, 678 (7th Cir. 2016) ("Although the plaintiffs could not describe in detail the process GreatBanc used, no such precision was essential."); *Braden v. Wal-Mart Stores, Inc.*, 588

F.3d 585, 594 (8th Cir. 2009) (ERISA cases generally involve participants with "limited access to crucial information").

The Opening Brief then noted the Complaint's allegations that (1) the ConocoPhillips funds were transitioned from a plan in which they were an employer security, (2) the fund assets no longer had the diversification exemption enjoyed by employer securities, (3) allocating 25% of a retirement plan portfolio to a single stock is a "patently risky investment strategy," and (4) the Plan was heavily invested in a correlated security. Opening Br. 34-35. Far from being an assertion of *res ipsa loquitur* (which is a basis for liability, not simply moving to discovery), as Defendants assert, the Opening Brief noted that these *facts* allowed plausible inferences at the motion to dismiss stage that Defendants engaged in an infirm investigation.

Of course, Plaintiffs cannot know the specifics of Defendants' investigation until the parties engage in discovery. But Plaintiffs are aware of no rule requiring that this case be pled with such specificity. Defendants did not cite one, and indeed, they did not even challenge the discussion in the Opening Brief of the myriad authorities establishing that the facts pled

and the permissible inferences therefrom were enough to plausibly plead a claim that Defendants did not properly investigate their decision to keep the Plan so heavily invested in a single non-employer stock. Thus, Defendants' infirm investigation was adequately pled.

III. The ConocoPhillips stock ceased being employer securities the moment ConocoPhillips ceased being the participants' employer.

As an alternative ground for affirmance, Defendants assert that the ConocoPhillips single-stock funds are composed of employer securities, and therefore, are exempt from any duty to diversify. Appellees' Br. 33-38. But they are not employer securities because ConocoPhillips is not the employer of the Plan's participants. An "employer security" is a "security issued by an employer of employees covered by the plan, or by an affiliate of such employer." 29 U.S.C. § 1107(d)(1). There is no dispute that ConocoPhillips is not the participants' employer (Phillips 66 is), nor is there any dispute that ConocoPhillips is not an "affiliate" of the participants' employer. ERISA defines an "employer" as a person "acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan." 29 U.S.C. § 1002(5). Because ConocoPhillips is not *acting* as the

participants' employer, ConocoPhillips stock is not an employer security in the Phillips 66 Plan.

The Internal Revenue Service agrees. In a private letter ruling, the IRS stated that a prior employer's shares are no longer "employer securities" after a spin-off. I.R.S. Priv. Ltr. Rul. 201427024 (July 3, 2014). The district court found the IRS's ruling "persuasive," even if it not binding, ROA.1210, and Defendants articulate no reason why it is not persuasive. The IRS ruling is consistent with Congress's intent to create a limited diversification exemption for employer securities. ESOPs are "both an employee retirement benefit plan and a technique of corporate finance that would encourage employee ownership." *Edgar v. Avaya*, 503 F.3d 340, 346 (3d Cir. 2007). The diversification exemption for "employer securities" exists to "bring about stock ownership by all corporate employees." *Dudenhoeffer*, 134 S. Ct. at 2469. The policy goals advanced by employee ownership are not advanced by participants' owning the stock of their *former* employers.

Defendants assert that the term "employer" locks in at the moment the stock is issued to the employee. It asks the Court to look at the word

"issued" in isolation and determine that the meaning of the term "employer" is fixed at the time the security is "issued." That is impossible, though, as the plain language of the statute requires that the employees be "covered by the plan." The Plan here did not exist when the participants were ConocoPhillips employees.

The case law Defendants cite does not support their reading. First, Defendants rely on a pre-2007, unpublished opinion from the Fourth Circuit that does not even involve ERISA. Appellees' Br. 35, citing *Manor Care of Am. v. Prop. & Cas. Ins. Guar. Corp.*, 185 Fed. Appx. 308 (4th Cir. 2006). There, the Fourth Circuit ruled that the phrase "issued to a resident" in a Maryland insurance statute should be determined by whether the insured was a "resident" at the policy's inception based on the statute's language and purpose. *Id*. Defendants ask this Court to apply that reasoning to ERISA—a different statute with different purposes. But they make no effort to justify the cross-application based on Congress's policy goals in enacting ERISA and, in particular, the exemption to the duty to diversify for employer securities. Nor do they address the differing ERISA language, which

requires that employees be "covered by the plan." As noted above, broadening the definition of employer would undermine—not advance—Congress's policy goals for ESOPs.

Defendants' reliance on *Tatum* only undermines their argument. Appellees' Br. 36-37. The Fourth Circuit acknowledged that the stock at issue was "employer securities" before the spin-off and the "unconfirmed assumption" of the defendants that diversification required divestiture. Appellees' Br. 37, citing *Tatum IV*, 761 F.3d at 359 & 360 n8. The district court confirmed that assumption in *Tatum V*, 2016 WL 660902, at *13-14, and the Fourth Circuit affirmed in *Tatum VI*, 855 F.3d at 563. The duty to diversify had to apply for the divestiture to be prudent. *Tatum V*, 2016 WL 660902, at *13-14. And while the defendants were imprudent not to confirm the assumption at the outset, the court ultimately found that if the defendants had conducted a proper investigation, they would have confirmed that divestiture was appropriate. *Id*. That is only possible if the stock at issue was *not* an employer security at the time of divestiture. The *Tatum* cases confirm that Defendants are wrongly interpreting the statute to claim that

the ConocoPhillips stock here remained "employer securities" after the participants were no longer ConocoPhillips employees.

Even if Defendants' theory on the word "issued" were accurate, the ConocoPhillips stock would still not be an "employer security." As Defendants acknowledge, the Plan received the stock in a transfer from the ConocoPhillips Plan. Appellees' Br. 5. So when the security was received by the Plan, it was transferred from the ConocoPhillips plan to a new plan that did not exist when the securities were first issued and that limited eligibility to employees of Phillips 66, not those of ConocoPhillips. The shares were held in trust by a trustee and a trust instrument under 29 U.S.C. § 1103(a) as they were transferred from the ConocoPhillips plan to the Phillips 66 plan. Indeed, the Summary Plan description confirms this, defining Phillips 66 stock as "Company Stock" and "employer securities," but not saying the same about the ConocoPhillips stock. ROA.614. Even if the ConocoPhillips plan qualified as an "affiliate" of ConocoPhillips, which it does not, that would not be enough. At that time, when the stock was issued to the participants' Plan accounts, they were Phillips 66 employees,

and even under Defendants' flawed construction, the shares were not employer securities.

This is not a mere nicety or a formality. It involves the conscious decision of the fiduciaries to simply roll stock from one plan where they were employer securities into a new plan where they were not employer securities. That decision required fiduciaries to investigate the ramifications and develop a prudent plan for disposition of the former employer securities. No prudent plan would involve simply closing the funds to new investment—a tacit admission that they knew the assets in the funds were not employer securities and not prudent investments—and otherwise leaving participants over-invested in a single stock. At the very least, after discovery and a trial, a reasonable factfinder could determine that, under the circumstances of this case, that inaction was imprudent.

CONCLUSION

For the foregoing reasons, Plaintiffs respectfully request that the district court's order dismissing this case be reversed and remanded.

Respectfully Submitted,

/s/ Tillman J. Breckenridge

Tillman J. Breckenridge
Gregory Y. Porter
Mark G. Boyko
BAILEY & GLASSER LLP
1054 31st St., NW, Suite 230
Washington, D.C. 20007
202-463-2101
tbreckenridge@baileyglasser.com

Robert A. Izard
Mark P. Kindall
Douglas P. Needham
IZARD KINDALL & RAABE LLP
29 South Main St., Suite 305
West Hartford, CT 06107
860-493-6292

Thomas R. Ajamie
John S. Edwards, Jr.
AJAMIE LLP
711 Louisiana, Suite 2150
Houston, TX 77002
713-860-1600

CERTIFICATE OF SERVICE

I certify that on September 13, 2018, the Reply Brief of Appellants was served on all parties or their counsel of record through the CM/ECF system.

/s/ Tillman J. Breckenridge
Tillman J. Breckenridge
BAILEY & GLASSER LLP
1054 31st St., NW, Suite 230
Washington, D.C. 20007
202-463-2101
tbreckenridge@baileyglasser.com

CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C), I certify that this Reply Brief of Appellants is proportionately spaced and contains 5,752 words excluding parts of the document exempted by Rule 32(a)(7)(B)(iii).

I further certify that (1) the required privacy redactions have been made, 5th Cir. R. 25.2.13; (2) the electronic submission will be an exact copy of the paper document, 5th Cir. R. 25.2.1; and (3) the document has been scanned for viruses with the most recent version of a commercial virus-scanning program and is free of viruses.

/s/ Tillman J. Breckenridge
Tillman J. Breckenridge
BAILEY & GLASSER LLP
1054 31st St., NW, Suite 230
Washington, D.C. 20007
202-463-2101
tbreckenridge@baileyglasser.com

September 13, 2018

Counsel for Appellants