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

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 Plaaintiffs/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

REQUEST FOR ORAL ARGUMENT

Plaintiffs-Appellants are participants in the Phillips 66 retirement plan who lost significant parts of their retirement assets due to the defendants' failure to diversify two investment funds. Those investment funds—which invested in ConocoPhillips stock—formerly had been exempted from ERISA diversification requirements because they were offered to ConocoPhillips employees in a ConocoPhillips pension plan. But after Phillips 66 was spun off from ConocoPhillips, they simply became imprudent, non-diversified, single-stock funds. This case raises critical questions of ERISA law. Oral argument is necessary to assist the Court in fleshing out the issues of how the duty to diversify operates under ERISA, how that duty is not abrogated by including other diversified options in a defined contribution plan's investment menu, and the role of the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer* in cases concerning the duty to diversify.

TABLE OF CONTENTS

INTRODUCTION 1

JURISDICTIONAL STATEMENT 2

ISSUE PRESENTED 2

STATEMENT OF THE CASE 3

A. PHILLIPS 66 SPINS OFF FROM CONOCOPHILLIPS AND FORMS THE PHILLIPS 66 SAVINGS PLAN 3

B. THE PHILLIPS 66 SAVINGS PLAN RETAINS THE SINGLE-STOCK CONOCOPHILLIPS STOCK FUNDS, EVEN THOUGH CONOCOPHILLIPS STOCK NO LONGER QUALIFIES AS AN EMPLOYER SECURITY. 4

C. CONOCOPHILLIPS'S STOCK DECLINES, COSTING THE PLAN AT LEAST TENS OF MILLIONS OF DOLLARS. 7

D. THE PLAINTIFFS SUE FIDUCIARIES OF THE PLAN, AND THE DEFENDANTS MOVE TO DISMISS. 8

E. THE DISTRICT COURT DISMISSES THE SUIT ON THE GROUND THAT FIDUCIARIES HAVE NO DUTY TO REMOVE IMPRUDENT FUNDS IF THE PLAN AS A WHOLE CONTAINS PRUDENT OPTIONS. 9

SUMMARY OF ARGUMENT 11

ARGUMENT 13

I. FAILURE TO DIVEST A SINGLE-STOCK FUND WITH THE FORMER EMPLOYER'S STOCK AFTER A SPIN-OFF VIOLATES THE DUTY TO DIVERSIFY. 13

A. ERISA STATES A STATUTORY DUTY TO DIVERSIFY. 13

1. EACH FUND WITHIN A PLAN MUST BE INDEPENDENTLY DIVERSIFIED UNDER 29 U.S.C. § 1104(A)(1)(B), AND DEFENDANTS VIOLATED THAT DUTY. 13

2. THE PLAN AS A WHOLE MUST BE DIVERSIFIED UNDER 29 U.S.C. § 1104(A)(1)(C), AND DEFENDANTS VIOLATED THAT DUTY AS WELL....20

B. THE PRESUMPTION OF PRUDENCE FOR RELYING ON THE PRICE OF A PUBLICLY-TRADED STOCK DOES NOT ABROGATE THE DUTY TO DIVERSIFY....24

II. DEFENDANTS FURTHER BREACHED THEIR FIDUCIARY DUTIES BY FAILING TO INVESTIGATE TO DETERMINE WHETHER THE SPIN-OFF WARRANTED DIVERSIFYING THE FUND. 29

TABLE OF AUTHORITIES

Page(s)

Cases

Allen v. GreatBanc Trust Co.,
835 F.3d 670 (7th Cir. 2016)....................34

Ashcroft v. Iqbal,
556 U.S. 662 (2009)....................30

Bausch v. Stryker Corp.,
630 F.3d 546 (7th Cir. 2010)....................31

Bell Atl. Corp. v. Twombly,
550 U.S. 544 (2007)....................32

Braden v. Wal-Mart Stores, Inc.,
588 F.3d 585 (8th Cir. 2009)....................31, 32, 33, 34

Bussian v. R.J.R. Nabisco, Inc.,
223 F.3d 286 (5th Cir. 2000)....................14

Delek Ref., Ltd. v. Occupational Safety & Health Review Comm'n,
845 F.3d 170 (5th Cir. 2016)....................14

DiFelice v. U.S. Airways, Inc.,
497 F.3d 410 (4th Cir. 2007)....................15, 16, 18

Erickson v. Pardus,
551 U.S. 89 (2007)....................30

Fifth Third Bancorp v. Dudenhoeffer,
134 S. Ct. 2459 (2014)....................*passim*

Hecker v. Deere & Co.,
569 F.3d 708 (7th Cir. 2009)....................15

Innova Hosp. San Antonio, L.P. v. Blue Cross and Blue Shield of Ga., Inc.,
892 F.3d 719 (5th Cir. 2018) 34, 36

Langbecker v. Electronic Data Systems Corp.,
476 F.3d 299 (5th Cir. 2007) 14, 16

Marshall v. Glass/Metal Ass'n,
507 F. Supp. 378 (D. Haw. 1980) 21, 22

Runnion ex rel. Runnion v. Girl Scouts of Greater Chicago & Nw. Indiana,
786 F.3d 510 (7th Cir. 2015) 30

Tatum v. RJ Reynolds Tobacco Co.,
No. 02-373, 2016 WL 660902 (M.D.N.C. February 18, 2016) 17

Tatum v. RJR Pension Inv. Cmte.,
855 F.3d 553 (4th Cir. 2017) 28

Tatum v. RJR Pension Inv. Committee,
761 F.3d 346 (4th Cir. 2014) 28, 29

Tibble v. Edison International,
135 S. Ct. 1823 (2015) 1, 18, 19, 23

Yates v. Nichols,
286 F. Supp. 3d 854 (N.D. Ohio 2017) 17, 22

Rules

Fed. R. Civ. P. 8(a)(2) 30

Statutes

28 U.S.C. § 1291 2

28 U.S.C. § 1331 2

29 U.S.C. § 1104...*passim*

29 U.S.C. § 1105...2

29 U.S.C. § 1109...2

29 U.S.C. § 1132...2

INTRODUCTION

This appeal ultimately comes down to one question: Does a fiduciary of a defined contribution pension plan necessarily meet its duty to diversify an inherently risky single-security investment fund offered in the plan's investment menu simply by also offering *other investment funds* that are safer? The answer is "no." It is "no" as a matter of statutory text. It is "no" as a matter of regulatory text. It is "no" based on prior holdings of the Supreme Court and this Court. And it is "no" because fiduciaries have an obligation to diligently utilize their greater expertise and time to remove obviously unsound investments from the menu of options available to employee-directed investment in a plan.

The Supreme Court already has decided this question. In *Tibble v. Edison International*, it plainly stated that "[a] plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones." 135 S. Ct. 1823, 1829 (2015). That statement, based on plain statutory language and settled case law, resolves *every* issue raised, and erroneously resolved, by the district court. It resolves

the question of whether fiduciary responsibilities end with initial fund selection, or whether fiduciaries are required to remove investments that later became imprudent. And it resolves the question of whether fiduciaries who offer plan participants *some* prudent investment options have a free pass to offer other investment options that are *not* prudent. Thus, the district court's determination that Defendants could not be liable for continuing to offer an imprudent, undiversified non-employer stock fund in the Phillips 66 Savings Plan is erroneous, warranting reversal and remand.

JURISDICTIONAL STATEMENT

The district court had jurisdiction under 28 U.S.C. § 1331 because the plaintiffs asserted an ERISA claim under 29 U.S.C. §§ 1104, 1105, 1109, and 1132. ROA.35. This Court has jurisdiction over this appeal of a final order disposing of Plaintiffs' claims under 28 U.S.C. § 1291. The district court entered final judgment on May 15, 2018. ROA.1236-37. Plaintiffs filed a timely notice of appeal on June 7, 2018. ROA.1238.

ISSUE PRESENTED

The Employee Retirement Income Security Act requires that fiduciaries of employee retirement funds diversify investments to satisfy the

duty of prudence, except in the case of a single-stock fund holding the employer's securities. Here, after Phillips 66 spun off from ConocoPhillips, fiduciaries retained two single-stock funds of the *former* employer's securities. The question presented for *de novo* review is whether a plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones.

STATEMENT OF THE CASE

A. Phillips 66 spins off from ConocoPhillips and forms the Phillips 66 Savings Plan.

In April 2012, Phillips 66 spun off from ConocoPhillips in a series of transactions that the companies referred to as the "Separation." ROA.16. Phillips 66 was previously a wholly owned subsidiary of ConocoPhillips. ROA.16. Phillips 66 became an independent, publicly traded company as a result of the Separation, and approximately 12,000 former ConocoPhillips employees became Phillips 66 employees. ROA.16.

Plaintiffs are participants in the Phillips 66 Savings Plan (the "Plan"), an employee benefit plan governed by ERISA. ROA.15-16. Phillips 66 established the Plan effective May 1, 2012, one day after the Separation, for

the purpose of helping its employees to save for retirement. ROA.15-16. The Plan is a defined contribution plan, meaning that each participant has an individual account that experiences gains or losses based on the investments allocated to the account itself. ROA.15. Participants decide how to allocate the assets in their accounts among the available investment funds. Defendants are Plan fiduciaries, responsible for overseeing the Plan and ensuring that there are diversified and prudent investment options within the Plan. ROA.15.

B. The Phillips 66 Savings Plan retains the single-stock ConocoPhillips stock funds, even though ConocoPhillips stock no longer qualifies as an Employer Security.

Contemporaneously with the spin-off and adoption of the Plan, the assets and liabilities former ConocoPhillips employees had in the ConocoPhillips Savings Plan were transferred to the Phillips 66 Savings Plan. ROA.17. Remaining ConocoPhillips employees were not permitted to participate in the Phillips 66 Plan. ROA.16. Of the $2.9 billion worth of assets transferred to the Plan, over $1 billion of it (more than 35%) was invested in two funds that *only* invested in ConocoPhillips stock. ROA.17, ROA.1197.

They were formerly part of the ConocoPhillips employee stock ownership plan. ROA.17, ROA.1197. Of course, since ConocoPhillips was no longer the participants' employer, the funds no longer qualified as ESOPs. ROA.22.

Even though the ConocoPhillips single-stock funds no longer held the advantages of employer securities, Defendants did not close the funds. At the time of transfer, the 35% ConocoPhillips concentration in the Plan dwarfed other outside investors' concentrations in that stock. The highest concentration mutual fund was an energy-focused fund that had less than 9% of its holdings in ConocoPhillips stock. ROA.18. Indeed, a mutual fund is considered "concentrated" if it has more than 25% of its stock in one *industry*, let alone one stock. Accordingly, even concentrated mutual funds are more diversified than the Plan was as a whole. Moreover, of all of the mutual funds in the world, the highest concentration of investment in ConocoPhillips stock was only an 8.78 percent concentration, and that was in a mutual fund specifically focused on the energy sector. Among diversified mutual funds, Vanguard's Total Stock Market Index had the highest concentration of ConocoPhillips stock at only 0.4% of the portfolio.

ROA.18. That amount is commensurate with the Phillips 66 Pension Plan—a defined benefit plan where the risk of loss is borne by the company rather than the employees—which likewise had only 0.4% of its assets invested in ConocoPhillips stock. ROA.19.

The Plan's high concentration of investment in ConocoPhillips stock was extraordinarily risky on its own, but that risk was compounded because the Plan also had a substantial concentration in the Plan's ESOP fund, which was primarily invested in Phillips 66 stock. At the end of 2013 and 2014, the Plan had 55% and 48%, respectively, of its assets invested in ConocoPhillips and Phillips 66 stocks. ROA.434 & ROA.489. Those stocks were in the same industry. Accordingly, there was a significant risk that whatever caused one to fall also would cause the other to fall. In late 2014, the correlation between the two stocks rose to higher than 75% on a 60-day rolling average. ROA.1203. While ERISA exempts ESOP funds from the duty to diversify, 29 U.S.C § 1104(a)(2), the existence of the undiversified Phillips 66 ESOP increased the risk that the Plan would suffer large losses by also investing in ConocoPhillips stock. ROA.20. The complaint alleges that Defendants failed

to investigate the risks inherent in such heavy concentration in the stocks of two related businesses. ROA.20.

Defendants recognized the dangers inherent in failing to diversify. They notified participants that their savings "may not be properly diversified" if they invest "more than 20% of [their] retirement savings in any one company or industry," all while over a third of the Plan was invested in one company and almost one-half of it was invested in one industry. ROA.29. And their recognition of the danger of being so heavily invested in ConocoPhillips stock is further established by the fact that they no longer allowed new investment in it after the spin-off. ROA.21. Yet Defendants did not perform an independent review to adequately attempt to ascertain the dangers in retaining the fund. ROA.21. They continually failed to review and ascertain the risk over several years. ROA.21.

C. ConocoPhillips's stock declines, costing the Plan at least tens of millions of dollars.

The price of ConocoPhillips stock went up briefly, but then it began a precipitous decline along with the price of oil. ROA.22. In 2014, the value of the stock fell from $86 to $76 per share in three months. ROA.23. Three

months later, it had fallen another $9 per share. ROA.25. By August 1, 2015, the price of ConocoPhillips stock had fallen to $49.80 per share, and it fell to $46.41 per share by the end of that year. ROA.26. Diversified investors lost money on ConocoPhillips stock in 2014 and 2015, but the losses were more than offset by other investments. The S&P 500 gained 13.69% in 2014 and another 1.38% in 2015. ROA.26.

D. The plaintiffs sue fiduciaries of the Plan, and the defendants move to dismiss.

Plaintiffs filed a complaint in October 2017, alleging causes of action for breach of fiduciary duty and co-fiduciary liability. ROA.33-36. They alleged that the defendants wrongfully allowed the Plan to retain "massive amounts of ConocoPhillips stock" and failed to follow an appropriate procedure to evaluate the investments in ConocoPhillips stock. ROA.34. They thus failed to appropriately diversify the Plan assets to protect against potential damage to the value of the Plan as a whole based on the reduction in the value of one company's stock. ROA.35.

In their motion to dismiss, Defendants argued that they were relieved of their duty to diversify because ConocoPhillips stock was an employer

security. ROA.1204. They also argued that, because there were other investment options in the Plan as a whole, they had no duty to prudently diversify any particular fund. ROA.1214. In response, Plaintiffs argued that ConocoPhillips stock was no longer an employer security as to the Phillips 66 employees after the spin-off. ROA.1209. Thus, Defendants had a duty to engage in an orderly diversification by reducing the Plan's reliance on ConocoPhillips stock. *Id*.

E. The district court dismisses the suit on the ground that fiduciaries have no duty to remove imprudent funds if the plan as a whole contains prudent options.

The district court granted the motion to dismiss. It recognized that the ConocoPhillips stock was not an employer security once ConocoPhillips no longer employed the participants, ROA.1212, but it ruled that fiduciaries have no duty to diversify specific funds if there are other funds employees can invest in. ROA.1216. The court quoted a district court decision suggesting that Defendants could not override the participants' decision to leave assets in the single-stock ConocoPhillips funds. ROA.1215-16. But notably, here, the Plan's fiduciaries have previously closed funds,

overridden participant decisions to invest in those funds, and forced the participants invested in them to move their assets. ROA.21. The district court nonetheless ruled that Defendants had no duty to ensure the prudence of all investment options. "Because the participants could elect to exchange their assets out of the ConocoPhillips Funds, any amount of the Plan's assets that remained invested in the ConocoPhillips Funds was there by the participants' choice." ROA.1216.

The district court further ruled that Plaintiffs had inadequately pled imprudence because, under *Dudenhoeffer*, reliance on the price of publicly-traded stock is presumptively prudent, absent special circumstances. ROA.1221. *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014). The court concluded that Plaintiffs failed to identify any "special circumstances" that might "undermin[e] the market price as a measure of ConocoPhillips' value." ROA.1221. The court thus dismissed the complaint with prejudice, and this appeal followed.

SUMMARY OF ARGUMENT

The district court engaged in a false dichotomy to rule that there was no claim here. According to the district court, "[t]he real issue is not diversification but the prudence of the fiduciaries' decision not to force divestiture." ROA1217. That is half right. The issue is whether the fiduciaries should have closed or limited the imprudent funds (or "force[d] divestiture" as the district court put it) in the interest of statutorily-required diversification.

Under 29 U.S.C. section 1104(a)(1), a plan administrator has a duty to diversify both the plan as a whole and each individual fund within it. Funds in employer securities are exempted, but the statute does not state an exemption for funds that hold securities of a former employer. This Court already has decided that there is a duty to prudently manage each fund in a plan and it is thus irrelevant whether participants have the option of choosing prudent funds and ignoring the imprudent options their fiduciaries provide.

Here, Defendants failed to prudently diversify or eliminate the single-stock ConocoPhillips funds, and as a result of their share of the Plan's total assets, also failed to diversify the Plan as a whole. Throughout the relevant period, the funds themselves held *only* ConocoPhillips stock, and the Plan was saddled with over a quarter of its holdings being invested in ConocoPhillips. As a result, the Plan suffered disproportionately when ConocoPhillips stock fell.

The district court wrongly dismissed the case on the theory that Plan participants are to blame because they did not avoid the imprudent funds themselves. That reasoning turns the fiduciary relationship on its head and contravenes clear statutory language and settled precedent. Nor was it correct for the district court to invoke the Supreme Court's holding in *Dudenhoeffer* that, absent special circumstances, it is presumptively prudent for a fiduciary to rely on the market price of the stock. Plaintiffs do not allege that Defendants improperly relied on the market price. To the contrary, the efficient pricing of the stock demonstrates that there was *no* reason to invest heavily in ConocoPhillips. In fact, *Dudenhoeffer* supports the need to

diversify holdings of publicly-traded stocks. Defendants here failed to diversify both at the fund and the plan level, and the district court erred by dismissing the case.

ARGUMENT

I. Failure to divest a single-stock fund with the former employer's stock after a spin-off violates the duty to diversify.

A. ERISA states a statutory duty to diversify.

1. Each fund within a plan must be independently diversified under 29 U.S.C. § 1104(a)(1)(B), and Defendants violated that duty.

The duty to diversify is inherent in ERISA, and the Act repeatedly stresses the importance of diversification. Most importantly, diversification is expressly part of the "prudent man standard of care." 29 U.S.C. § 1104. The Act requires a fiduciary to "discharge his duties . . . by diversifying 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." 29 U.S.C. § 1104(a)(1)(C). Diversification is part of the fiduciary duty to act "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." 29 U.S.C. § 1104(a)(1)(B), 1104(a)(2); *see also Bussian v. R.J.R. Nabisco, Inc.*, 223 F.3d 286, 294 (5th Cir. 2000) (noting the duty to diversify under section 1104(a)(1)(B)).

The duty to diversify operates both at the plan level and at the level of individual funds within a plan. It is not enough to simply diversify the plan as a whole. That much is clear from the Act. While section 1104(a)(1)(C) states a duty to diversify the plan as a whole (together with a presumption that a failure to diversify the plan violates the Act), the duty to diversify under section 1104(a)(1)(B) covers different ground. *Bussian*, 223 F.3d at 294. It must; otherwise it would be surplusage. *Delek Ref., Ltd. v. Occupational Safety & Health Review Comm'n*, 845 F.3d 170, 177 (5th Cir. 2016) (Fifth Circuit "precedents have repeatedly cautioned against interpreting statutes" to render parts meaningless).

This Court already has recognized that each individual fund in a plan must be prudently managed, and it is not enough to simply provide participants with a mix of options—some prudent and some imprudent—and then leave them to their own devices. *Langbecker v. Electronic Data*

Systems Corp., 476 F.3d 299, 308 n.18 (5th Cir. 2007); *see also Hecker v. Deere & Co.*, 569 F.3d 708, 711 (7th Cir. 2009) (a fiduciary's plan to "insulate itself from liability" by "including a very large number of investment alternatives in its portfolio and then shifting to the participants the responsibility for choosing among them . . . would place an unreasonable burden on unsophisticated plan participants who do not have the resources to pre-screen investment alternatives").

In *DiFelice v. U.S. Airways, Inc.*, the Fourth Circuit reviewed an order granting judgment against a plaintiff who sued his employer over the loss in value of employer stock in the plan. 497 F.3d 410, 414 (4th Cir. 2007). The plan gave the employer discretion to determine the number and types of funds within the plan, but the individual employees could choose their allocations within the plan. *Id*. "[T]he onus was on the participants to manage their investments." *Id*. at 415. The employer further warned that the single-stock fund containing company stock was the riskiest part of the portfolio and emphasized the importance of diversification. *Id*.

Quoting this Court's decision in *Langbecker*, the court ruled that the fiduciary "must initially determine, and continue to monitor, the prudence of *each* investment option available to plan participants." *Id*. at 423. Therefore, the relevant portfolio for analyzing prudence was "*each* available Fund considered on its own, including the Company Fund, not the full menu of Plan funds." *Id*. The court went on to say that "a fiduciary cannot free himself from his duty to act as a prudent man simply by arguing that other funds, which individuals may *or may not* elect to combine with a company stock fund, could theoretically, in combination, create a prudent portfolio." *Id*. The Fourth Circuit ultimately ruled in the employer's favor, despite the fact that "placing retirement funds in *any* single-stock fund carries significant risk, and so would seem generally *imprudent* for ERISA purposes, Congress has explicitly provided that qualifying concentrated investment in *employer* stock does not violate the 'prudent man' standard per se." *Id*. at 424.

Rather than follow the in-circuit and out-of-circuit appellate authority, the district court relied heavily on an out-of-circuit district court case, *Yates*

v. Nichols, 286 F. Supp. 3d 854 (N.D. Ohio 2017), to foist onto participants the duty to study the investments within the Plan and become the experts their fiduciaries are supposed to be. ROA.1215-16. According to the district court, the imprudence of the single-stock fund itself is irrelevant because the participants had other, purportedly prudent, options in which to invest. ROA.1216. But those participants have other jobs and areas of expertise. *Id*. They are not retirement investment experts. Accordingly, they depend on ERISA to require Plan fiduciaries to provide them only with diversified and prudent options.

Here, the single-stock fund is, by its very nature, *not* diversified and very risky. The district court did not find otherwise; indeed, it acknowledged the risk. ROA.1217. Because of that nature, it is imprudent to offer a single-stock fund unless it is an employer securities fund expressly exempted from the duty to diversify by the Act. *See Tatum v. RJ Reynolds Tobacco Co.*, No. 02-373, 2016 WL 660902, *13 (M.D.N.C. February 18, 2016) ("[a] single-stock fund is 'approximately four times as risky as a diversified portfolio of mutual funds'"). The district court's ruling creates exactly the

"perverse" result the Fourth Circuit warned against—it "mean[s] that any single-stock fund, in which that stock existed in a state short of certain cancellation without compensation would be prudent if offered alongside other, diversified funds." *DiFelice*, 497 F.3d at 423-24. Plan participants deserve better than that from their fiduciaries, and the plain language of the Act, along with the subsequent case law, require that *every* fund offered be prudent.

The fact that the funds were rolled over from the prior plan at ConocoPhillips does not change any of the analysis. Without citing any authority, the district court ruled that Defendants had no duty to ensure the prudence of the individual fund "[b]ecause Defendants did not mandate that participants' assets remain in ConocoPhillips Funds." But that same reasoning would apply to *any* fund a participant chooses from a plan menu, and that reasoning has been rejected by myriad circuit courts, including this one, as noted above.

The Supreme Court already answered this question with respect to a defined-contribution plan (like the Plan here) in *Tibble v. Edison International*.

135 S. Ct. 1823 (2015). There, in reversing a grant of judgment in favor of an ERISA fiduciary defendant, the Supreme Court plainly stated that "a trustee has a continuing duty to monitor trust investments *and remove imprudent ones*." *Id*. at 1828. It went on to say that "[t]his continuing duty exists separate and apart from the trustee's duty to exercise prudence in selecting investments at the outset." *Id*. Then, it conclusively answered the question presented here: "A plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones." *Id*. at 1828-29.

Plan managers regularly close individual funds, thereby forcing participants to move assets to other funds (or in lieu of that, moving the assets for them). Indeed, the complaint here alleges that the administrator has closed funds in *this* Plan, which of course forced participants' assets to be moved to other funds. ROA.21. Likewise, Defendants easily could have closed the ConocoPhillips stock funds and (1) given participants a certain amount of time to reinvest, or (2) moved them to another, diversified, fund and notified them of the change so they could then move the assets to the

prudent fund(s) of their choosing. Instead, Defendants chose to sit on their hands. And that certainly is not prudent as a matter of law. For that reason alone, the decision below should be vacated, and the case should be remanded for further proceedings.

2. The Plan as a whole must be diversified under 29 U.S.C. § 1104(a)(1)(C), and Defendants violated that duty as well.

Plaintiffs also plausibly pled that the Plan as a whole was not prudently diversified, and the defendants thus violated section 1104(a)(1)(C) as well. Section 1104(a)(1)(C) requires fiduciaries to "diversify[] the investments of the plan so as to minimize the risk of large losses." 29 U.S.C. § 1104(a)(1)(C). It creates a presumption of imprudence if a plan is not diversified. *Id*.

At the end of 2014, more than a-year-and-a-half after the spin-off, the Plan had more than 25% of its assets in ConocoPhillips stock. ROA.18. That is not diversified under any measure and at least creates a triable issue of fact whereby a reasonable factfinder could determine—with the help of expert testimony—that the Plan was not properly diversified. Indeed, the

District of Hawaii found that a plan was not diversified "on its face" when it had a 23% concentration in one investment. *Marshall v. Glass/Metal Ass'n*, 507 F. Supp. 378, 384 (D. Haw. 1980). Investment authorities regularly recommend that any investment portfolio is over-concentrated when there is such a high percentage of a portfolio in one stock. Defendants' own Summary Plan Description states that "[i]f you invest more than 20% of your retirement savings in any one *company or industry*, your savings may not be properly diversified." ROA.29.

As a point of comparison, the mutual fund with the highest concentration of ConocoPhillips stock—an energy industry fund that acknowledges that it is not diversified—was only 8.78% concentrated. ROA.18. And the highest concentration in a "diversified" fund was Vanguard's Total Stock Market Index at less than 0.4%. *Id*. The Plan still had more ConocoPhillips stock than all other domestic stock funds combined at the end of 2014. ROA.489. There simply is no argument that the Plan, *as a matter of law*, met Section 1104(a)(1)(C)'s diversification requirement.

The district court never ruled that the plan, as a whole, was prudently diversified to "minimize the risk of large losses," and Defendants did not argue as much below. 29 U.S.C. § 1104(a)(1)(C). Indeed, highlighting its own error, the district court recognized that "[b]ecause the shares of ConocoPhillips are no longer employer securities, a fiduciary's decision to allocate 25% of the plan's assets to the ConocoPhillips Funds might, hypothetically, violate the duty to diversify the plan's investments." ROA.1217. But the court contravened the plain language of Section 1104(a)(1)(C) by finding that, despite potentially violating the duty to diversify, Plaintiffs could not state a cause of action because they did not "challenge the diversity of the investment *options*." ROA.1215 (emphasis added). To reach that conclusion, the court relied on *Yates v. Nichols*, 286 F. Supp. 3d 854 (N.D. Ohio 2017), which was wrongly decided, and in any event, involved a plan with under seven percent concentration in a single stock. ROA.1214-15. Indeed, the court in *Yates* specifically distinguished *Marshall* because the plan at issue was 23% concentrated. 286 F. Supp. 3d at 864.

The district court wrongly found that Plaintiffs could not state a claim unless they alleged that Defendants either required participants to keep assets in the ConocoPhillips funds or failed to provide other prudent and diversified options in the Plan. ROA.1217. Under the district court's reasoning, so long as Defendants provided only one diversified and otherwise prudent fund in which participants could place their assets, the lack of diversification and imprudence of any and all other funds is irrelevant. Section 1104(a)(1)(C) is not so cabined. Its plain language states that the "*plan*" must be diversified to "minimize the risk of large losses" to the plan. 29 U.S.C. § 1104(a)(1)(C) (emphasis added). And the Supreme Court held in *Tibble* that there is a duty to remove imprudent investments regardless of whatever else is in the plan. 135 S. Ct. at 1829 ("A plaintiff may allege that a fiduciary breached the duty of prudence by failing to properly monitor investments and remove imprudent ones.").

The district court here has stated its own error, the case it relies on distinguishes itself, and granting the motion to dismiss was improper. The factfinder should have the advantage of a trial with expert testimony to

determine whether it was imprudent not to close the funds or otherwise quickly cause them to partially divest to protect the Plan from the risks of a lack of diversification. The district court's approach changes the duty to diversify to a duty-to-provide-at-least-one-diversified-option. There simply is no authority or reasoned concept of the role of a fiduciary that can support contravening the plain language of Section 1104(a)(1)(C) like that.

B. The presumption of prudence for relying on the price of a publicly-traded stock does not abrogate the duty to diversify.

Relying on the Supreme Court's decision in *Dudenhoeffer*, the district court found that Plaintiffs failed to show that continued investment in ConocoPhillips stock was imprudent because they failed to allege "special circumstances" that would undermine reliance on the price of publicly-traded stock. But *Dudenhoeffer's* grounds for dismissal do not apply here, where Plaintiffs argue that investment in ConocoPhillips stock was imprudent because the investment was undiversified. To the contrary, *Dudenhoeffer* demonstrates that the Plan should not have invested in the undiversified ConocoPhillips stock fund, particularly given the Plan's

investment in the highly correlated and highly-concentrated single-stock fund, the Phillips 66 stock fund.

Dudenhoeffer involved investment in an undiversified fund primarily invested in the stock of the plan participant's employer—a classic ESOP fund. 134 S. Ct. at 2463-64. The potential imprudence of the failure to diversify was not an issue because the stock was part of an employee stock ownership plan, which is statutorily exempted from the duty to diversify. *Id*. at 2467.

The Supreme Court focused on characteristics endemic to evaluating the prudence of relying on market prices for publicly traded securities that are not relevant to determining whether an investment is properly diversified. 134 S. Ct. 2459 (2014). There, a Fifth Third Bancorp employee sued Fifth Third and other fiduciaries for breach of fiduciary duty in connection with the company's employee stock ownership plan. *Id*. at 2464. The complaint alleged that the Fifth Third plan's fiduciaries "knew or should have known that Fifth Third's stock was overvalued and excessively risky." *Id*. Despite myriad publicly disclosed indicia of risk, the fiduciaries did

nothing to decrease holdings in Fifth Third stock before the price fell by 74% in just over two years. *Id*.

After cautioning that evaluating the duty of prudence must be "context specific," the Supreme Court stated that "where a stock is publicly traded, allegations that a fiduciary should have recognized from publicly available information alone *that the market was over- or undervaluing the stock* are implausible as a general rule, at least in the absence of special circumstances." *Id*. at 2471 (emphasis added). The court went on to note how investors rely on the market as a sober and unbiased view of the value of a stock. *Id*. This reliance is reasonable "in light of all [the] public information" made available under the securities laws to the market. *Id*. Thus, ERISA fiduciaries "as a general matter, likewise prudently rely on the market price." *Id*. "In other words, a fiduciary usually 'is not imprudent to assume that a major stock market . . . provides the best estimate of the value of the stocks traded on it that is available to him.'" *Id*. The Supreme Court *did not* eliminate all concepts of a duty of prudence involving publicly-traded

stock, it only created a presumption that fiduciaries can prudently rely on market price in making their decisions.

Here, Plaintiffs are not arguing that ConocoPhillips stock was an imprudent investment because it was over-priced. Instead, Plaintiffs' imprudence argument is based on the failure to diversify. The concentration risk of over-investing in a stock is *not* reflected in the stock's per-share price. By definition, the per-share price is how the market values a single share. So, to the extent the complaint relied on public information that may affect the stock price, it was information that allowed every other major investor on the planet to know to steer clear of concentrating its portfolio in ConocoPhillips stock to the tune of a quarter or a third of the portfolio's value. Since the stock funds at issue here, unlike the ESOP at issue in *Dudenhoeffer*, have no statutory exemption from ERISA's diversification requirements, *Dudenhoeffer* demonstrates that the ConocoPhillips funds are not prudently diversified.

Plaintiffs allege that even if the market perfectly valued the stock—indeed, *especially* if the market perfectly valued the stock—there was no

reason to have so many eggs in one basket, when any stock can drastically and suddenly lose value. Accordingly, the efficient market theory underlying *Dudenhoeffer* counsels *against* presuming that a high concentration of stock in one publicly-traded company is prudent. Given the risk of large losses with any individual stock, there is no reason to heavily invest in one stock that is properly valued by the market, when there are numerous other properly-valued options that would allow a fiduciary to hedge the risk that one company could have a tragic turn that devalues its stock. As the Supreme Court noted in *Dudenhoeffer*, an ordinary "retirement plan (1) seeks to maximize retirement savings while (2) avoiding excessive risk." 134 S. Ct. at 2467-68. *See also Tatum v. RJR Pension Inv. Cmte.*, 855 F.3d 553, 566 (4th Cir. 2017) ("Simply following the market's pricing of a stock at a given time cannot satisfy a fiduciary's duty 'to conduct a regular review of its investment.'"). A lack of diversification is the "poster child" for that excessive risk.

The Fourth Circuit dealt directly with the application of *Dudenhoeffer* and excessive risk to an undiversified, non-employer stock fund in *Tatum v.*

RJR Pension Inv. Committee, 761 F.3d 346 (4th Cir. 2014). After noting that, under *Dudenhoeffer*, "it is not imprudent to assume that a major stock market . . . provides the best estimate of value" (quoting *Dudenhoeffer* at 2471), the Court stated that the fiduciaries had no reason to think that the [non-employer stock funds] would have provided above-market returns, given the public nature of the relevant financial information and the general efficiency of the stock market." *Id*. at 382 (citation omitted). Accordingly, the Court held that sale of the non-employer stock was "arguably" "the *most* prudent of the options available, for it protected plan participants from risky shares held in undiversified plan funds." *Id* at 383 (emphasis in original). The same is true here concerning the ConocoPhillips funds.

II. Defendants further breached their fiduciary duties by failing to investigate to determine whether the spin-off warranted diversifying the fund.

Plaintiffs also have adequately alleged that Defendants engaged in a flawed process by failing to monitor, evaluate, and mitigate the concentration risk from the ConocoPhillips funds. Federal Rule of Civil Procedure 8 requires that a complaint present "a short and plain statement

of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a)(2). A complaint will survive a Rule 12(b)(6) motion to dismiss if it contains "sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). *Iqbal* and *Twombly* do not impose a "probability requirement." *Iqbal*, 556 U.S. at 678. Rather, a complaint states a plausible claim for relief if the factual allegations "allow[] the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* A plaintiff is not required to plead "specific facts," but "need only 'give the defendant fair notice of what the . . . claim is and the grounds upon which it rests.'" *Erickson v. Pardus*, 551 U.S. 89, 93 (2007) (quoting *Twombly*, 550 U.S. at 555) (citation, punctuation omitted); *see also Runnion ex rel. Runnion v. Girl Scouts of Greater Chicago & Nw. Indiana*, 786 F.3d 510, 517 (7th Cir. 2015) (plaintiff is not required "to allege in her complaint facts supporting specific legal theories" because the Rules "do not require code pleading").

An ERISA complaint "should be read as a whole, not parsed piece by piece to determine whether each allegation, in isolation, is plausible." *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 594 (8th Cir. 2009) (citing *Vila v. Inter-Am. Inv. Corp.*, 570 F.3d 274, 285 (D.C. Cir. 2009) (factual allegations should be "viewed in their totality")). This approach is especially vital to ERISA fiduciary duty actions in which private individuals take the "important role" Congress placed on them to "enforc[e] ERISA's fiduciary duties" and "prevent through private civil litigation misuse and mismanagement of plan assets." *Braden*, 588 F.3d at 597-98 (citations, punctuation omitted). A "holistic evaluation of an ERISA complaint's factual allegations" is counseled by plaintiff-participants' "limited access to crucial information" about facts that "tend systemically to be in the sole possession of defendants." *Id.* at 598; *cf. Bausch v. Stryker Corp.*, 630 F.3d 546, 561 (7th Cir. 2010) (refusing under Rule 12(b)(6) standards to fault plaintiff for failing to plead confidential facts unknown to her that she could only access through discovery).

In *Braden*, "[t]he gravamen of the complaint [was] that [defendants] failed to adequately evaluate the investment options included in the Plan," costing the plan tens of millions of dollars. *Id*. at 589-90. The defendants in *Braden* contested only the second prong for breach of fiduciary duty under ERISA—whether there were sufficient allegations to support finding a breach. *Id*. The plaintiff did not "describe directly the ways in which [defendants] breached their fiduciary duties" under ERISA, *id*. at 595, so the district court dismissed the breach of fiduciary duty claims on the ground that "Braden had alleged insufficient facts to support the claim of imprudent or disloyal management." *id*. at 591.

The Eighth Circuit pointed to the Supreme Court's directive in *Bell Atlantic Corporation v. Twombly*, 550 U.S. 544, 556 (2007), that a district judge cannot dismiss a complaint based on finding that proving the allegations would be improbable. *Braden*, 588 F.3d at 594. In light of the requirement that Braden ultimately prove that the defendants engaged in a flawed process of making investment decisions, the district court had "the mistaken assumption" that Braden had to specifically allege the fiduciaries' flawed

conduct. *Id*. at 595. "Rule 8 does not, however, require a plaintiff to plead 'specific facts' explaining precisely how the defendant's conduct was unlawful." *Id*. A plaintiff need only "plead facts indirectly showing unlawful behavior, so long as the facts pled 'give the defendant fair notice of what the claim is and the grounds upon which it rests.'" *Id*. Thus, it was enough for Braden to allege that: (1) plans of that size normally can obtain "institutional class shares of mutual funds," (2) the plan obtained only "retail class" shares, and (3) such shares require higher payments of fees. *Id*. Braden also alleged that other fees were charged unnecessarily, and the defendants did not change out underperforming funds. *Id*.

The Eighth Circuit stated that the district court "correctly noted that none of these allegations directly addresses the process by which the plan was managed," but it was reasonable to infer from the allegations that the defendants engaged in a flawed process. *Id*. The court further recognized the challenges ERISA plaintiffs have in stating a cause of action: "No matter how clever or diligent, ERISA plaintiffs generally lack the inside information necessary to make out their claims in detail unless and until discovery

commences." *Id*. at 598. *See also 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. It was enough to allege facts from which a factfinder could infer that the process was inadequate."). This Court adopted that reasoning in *Innova Hosp. San Antonio, L.P. v. Blue Cross and Blue Shield of Ga., Inc.*, 892 F.3d 719, 728-29 (5th Cir. 2018). "[W]hen discoverable information is in the control and possession of a defendant, it is not necessarily the plaintiff's responsibility to provide that information in her complaint." *Id*. at 730.

Here, Plaintiffs pled myriad facts that support an inference that Defendants failed to engage in an adequate process to protect participants' interests. Plaintiffs described how no fiduciary engaging in an adequate process could have made the mistake of simply transitioning funds in an employee stock ownership plan to the new Plan when those funds no longer have the advantages or protections employee stock ownership plans enjoy. ROA.23. They further described that an adequate process would have revealed that the concentration in ConocoPhillips stock—over 25% of Plan

assets at relevant times—was a patently risky investment strategy, ROA.18-19, ROA.29, and that is especially true considering that the Plan was also heavily invested in highly correlated Phillips 66 stock as part of the Plan's employee stock ownership plan, ROA19, ROA29-30.

The district court did not address the inferences that can and do arise from the allegations. The court simply dismissed statements that "Defendants did not follow an appropriate process" as "conclusory" without citing any part of the complaint beyond the conclusions. ROA.1222. The court made this ruling despite quoting authority that notes that a complaint may raise a plausible inference of failing to engage in an adequate process by pointing to behavior and outcomes indicating the process was "plainly risky." ROA.1223. Of course, the complaint alleges that failing to actively diversify the Plan, as well as having a single-stock fund made up of non-employer stock, were plainly risky. *E.g.*, ROA.28 ("Because the value of any single stock is tied to the fortunes of one company, holding a single stock is unduly risky."); ROA.26 ("Even with this massive decline in the price of ConocoPhillips stock and the high correlation to Phillips 66 stock,

Defendants still took no action to mitigate the Plan's risks or losses or protect participants from the staggering amount of retirement savings they were losing.").

The district court did not refer to the sentence before one of the statements it dismisses as "legal conclusions." The complaint states that Defendants "failed to independently assess the ConocoPhillips Funds to ensure they were prudent and failed to continually monitor these investments' inclusion in the Plan." ROA.19. And the sentence before it supports that conclusion, stating that the "concentrated position should have been a red flag to the Defendants that they needed to diversify the Plan's assets in order to avoid the *risk* of large losses." *Id*. (emphasis added).

The complaint adequately alleges that Defendants failed to engage in an adequate process, as Defendants failed time and again to adequately diversify both at the fund level and for the Plan as a whole. No adequate process would cause a fiduciary to leave plan assets vulnerable to the risk of the single-stock ConocoPhillips funds after they no longer provided the benefits of an employee stock ownership plan. No adequate process would

cause a fiduciary to simply transition a single-stock fund to a new plan in a way that makes that fund a third of the plan's assets. No adequate process would cause a fiduciary to leave those assets in the plan where it still made up a quarter of plan assets two years later. And no adequate process would cause a fiduciary to ignore the fact that a single-stock fund exposes participants to greater concentration risk when that single stock fund is correlated to a single-stock employee stock ownership plan in the same industry, bringing their combined concentration to over half of plan assets. For these reasons, as well as the failure to diversify itself, the decision below should be reversed.[1]

[1] In light of revival of either or both of these claims, claims of breach of co-fiduciary duty, which were dismissed by the district court based on its dismissal of these claims, ROA.1224, would be revived.

CONCLUSION

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

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 July 31, 2018, the 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 Brief of Appellants is proportionately spaced and contains 6,842 words excluding parts of the document exempted by Rule 32(a)(7)(B)(iii).

I further certify that (1) 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

July 31, 2018

Counsel for Appellants