No. 97-1899

In the Supreme Court of the United States

OCTOBER TERM, 1997

NATIONSBANK OF GEORGIA, N.A. AND SOVRAN CAPITAL MANAGEMENT CORPORATION, PETITIONERS

v.

ALEXIS M. HERMAN, SECRETARY OF LABOR

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

SETH P. WAXMAN
Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514–2217

MARVIN KRISLOV
Deputy Solicitor for National Operations

ALLEN H. FELDMAN
Associate Solicitor

NATHANIEL I. SPILLER
Deputy Associate Solicitor

ELIZABETH HOPKINS
Attorney
Department of Labor
Washington, D.C. 20210

QUESTIONS PRESENTED

1. Whether the court of appeals correctly held that plan participants in an employee stock ownership plan (ESOP) were not "named fiduciaries" under 29 U.S.C. 1103(a)(1) with respect to the disposition of the ESOP's shares of stock that were not allocated to the plan participants, and that the ESOP trustee therefore was subject to the requirement under 29 U.S.C. 1104(a)(1)(B) that a fiduciary prudently discharge its duties with respect to plan asset management.

2. Whether the court of appeals properly remanded the case to the district court for a determination whether an ESOP trustee received "proper directions" under 29 U.S.C. 1103(a)(1) from plan participants regarding allocated unvoted ESOP shares.

3. Whether an informational letter from the Secretary of Labor is entitled to deference when the Secretary invokes a deliberative process privilege in discovery.

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OPINIONS BELOW

The per curiam opinion of the court of appeals denying rehearing (Pet. App. 1a-3a) is reported at 135 F.3d 1409. The opinion of the court of appeals (Pet. App. 4a-33a) is reported at 126 F.3d 1354. The opinions of the district court (Pet. App. 34a-47a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on November 5, 1997. The petition for rehearing was denied on February 25, 1998. The petition for a writ of certiorari was filed on May 26, 1998. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Employee Retirement Income Security Act of 1974 (ERISA), an employee stock ownership plan (ESOP) may invest plan assets primarily or exclusively in securities issued by the sponsoring employer or affiliates of such employer. 29 U.S.C. 1107(d)(6). Although an ESOP is governed by the same fiduciary rules that govern the administration and operation of other employee benefit plans, ESOPs are exempt from ERISA's ten-percent limitation on plan investments in employer securities or real estate, 29 U.S.C. 1107(a) and (b)(1), and from the duty to diversify plan investments, 29 U.S.C. 1104(a)(2).

In all other respects, assets of an ESOP must be held in trust and a named trustee must have exclusive authority and discretion to manage and control such assets. 29 U.S.C. 1102(a)(1) and (2), 1103(a). Thus, an ESOP trustee is subject to ERISA's requirement that a fiduciary discharge its duties with respect to plan assets "solely in the interest" of plan participants and beneficiaries and (1) for the exclusive purpose of providing benefits and defraying reasonable administrative expenses; (2) "with the care, skill, prudence and diligence" of "a prudent man" acting under similar circumstances; and (3) in accordance with the plan documents and instruments to the extent that they are consistent with ERISA. 29 U.S.C. 1104(a)(1)(A), (B) and (D).

ERISA provides, however, that a trustee of a pension plan is relieved of its fiduciary duties over plan assets "to the extent" that the plan expressly provides that the trustee is subject to the direction of a "named fiduciary" who is not a trustee. 29 U.S.C. 1103(a)(1). In that event, the trustee is considered a

directed trustee and is "subject to proper directions of [the named] fiduciary which are made in accordance with the terms of the plan and which are not contrary to [ERISA]." *Ibid.*

2. In 1988, partly in response to a hostile takeover attempt by Shamrock Acquisitions, III, Inc., Polaroid Corporation established the Polaroid Stock Equity Plan, an ESOP. Pet. App. 6a. Polaroid named petitioner NationsBank of Georgia, N.A., as trustee of the ESOP. *Ibid.*[1] Polaroid financed the ESOP's original purchase of 9.7 million shares of newly issued Polaroid common stock through a $15 million cash contribution and a $285 million loan to the plan. The shares purchased through the cash contribution were allocated to the accounts of the individual plan participants, while the shares purchased with the proceeds of the loan were placed into an unallocated account, where they served as collateral for the loan. *Ibid.* As the ESOP made loan payments to Polaroid (out of subsequent Polaroid contributions), the ESOP released shares in the unallocated account on a proportional basis into the individual accounts of the participants. *Id.* at 6a-7a. At the time of the tender offers at issue in this case, more than 90% of the shares of the ESOP were unallocated. *Id.* at 38a.

The ESOP plan document contains a "pass-through voting" provision, under which participants can vote or tender the shares allocated to their accounts in the same manner as ordinary shareholders. Pet. App. 7a. The plan document provides that the ESOP trustee may not tender a participant's allocated shares unless

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[1] Petitioner Sovran Capital Management Corporation provided investment advice to the ESOP during the relevant period. Pet. App. 6a.

specifically instructed by that participant to do so, and that the trustee should interpret the participant's silence as an instruction not to tender his shares. *Ibid.* The plan document also contains a "mirror voting" provision, which instructs the trustee to tender unallocated shares in the same proportion as it tenders allocated shares. *Ibid.*

Almost immediately after the creation of the Polaroid ESOP, Shamrock filed suit in state court challenging the legality of the ESOP. Pet. App. 6a n.2, 38a. In September 1988, Shamrock ultimately made a tender offer of $45 a share for all of Polaroid's common stock, contingent upon the success of its state court suit. *Id.* at 7a-8a. In January 1989, Polaroid responded with a self-tender offer of $50 per share for a maximum of 16 million of its 71.5 million shares of common stock. In February 1989, NationsBank sent plan participants a notice of the competing tender offers, which informed them of their right under the plan to tender their allocated shares to Shamrock, to tender them Polaroid, or not to tender at all. The notice informed the participants that any non-response would be treated as an instruction not to tender a participant's allocated shares. The notice, however, made no mention of the "mirror voting" provision under which unallocated shares would be voted in the same proportion as allocated shares. *Id.* at 8a, 38a-39a.

Also in February 1989, the Secretary of Labor sent NationsBank a letter notifying NationsBank that, as an ESOP trustee, NationsBank bore the ultimate responsibility for deciding whether to tender the ESOP's unallocated shares, and that NationsBank could follow the "mirror voting" provision only to the extent that such a course of action was consistent

with ERISA and its fiduciary duty provisions. The Secretary also stated her view that NationsBank was responsible for deciding the prudence of tendering the allocated shares for which the trustee received no voting instructions from plan participants. Pet. App. 8a.

NationsBank's Trust Policy Committee subsequently met to consider the prudence of each available tender option. Pet. App. 8a-9a. The Committee decided that it would be prudent to choose any of the three available options. Based on that determination, NationsBank followed the "mirror voting" provision and tendered the unallocated shares in proportion to the allocated shares that the participants affirmatively elected to tender. NationsBank also followed the plan provision as to the allocated unvoted shares. *Id*. at 9a. Accordingly, NationsBank tendered 5,239,460 shares to Polaroid, but did not tender 4,332,044 shares. *Id*. at 9a-10a, 39a. Polaroid accepted 27.7747% of the shares tendered by each shareholder, and NationsBank reinvested the funds received in Polaroid stock, thus increasing the ESOP's stake in Polaroid by 482,073 shares. The ESOP would have obtained an additional 332,917 shares, however, had NationsBank tendered to Polaroid all of the unallocated shares and the allocated shares that the participants failed to vote. *Id*. at 10a.

3. In 1992, the Secretary filed suit against petitioners in district court alleging that they violated the duties of prudence and loyalty under 29 U.S.C. 1104(a)(1)(A) and (B), by failing to tender all unallocated and allocated unvoted shares to Polaroid, whose $50 tender offer was well above market. On cross-motions for summary judgment, the district court held that, with respect to the allocated shares

for which NationsBank received voting instructions from participants, NationsBank was a directed trustee under 29 U.S.C. 1103(a)(1), and thus it was relieved of its fiduciary duties to that extent. Pet. App. 41a. The district court concluded, however, that, with respect to the unallocated shares and the allocated unvoted shares, NationsBank was not a directed trustee and therefore had a fiduciary duty to make prudent investment decisions in the sole interest of plan participants. *Id.* 45a-46a. The district court then set the matter for trial to determine whether NationsBank breached its duty with respect to the voting of the unallocated and allocated unvoted shares. *Id.* at 46a-47a.[2]

4. On interlocutory appeal pursuant to 28 U.S.C. 1292(b), the court of appeals affirmed in part and reversed in part. Pet. App. 4a-33a. With respect to the unallocated shares, the court of appeals held that the ESOP participants were not named fiduciaries within the meaning of 29 U.S.C. 1103(a)(1), "because the tender notice did not inform [plan participants] of their power and control over the unallocated shares." Pet. App. 21a. The court reasoned that in order to have the requisite discretionary authority over plan assets to meet the definition of a fiduciary under 29 U.S.C. 1002(21)(A), a person must necessarily have knowledge of his authority. *Id.* at 21a-23a, 25a. Because NationsBank's tender option notice did not inform the ESOP participants that the voting of their shares would control the voting of the unallocated shares, the court concluded that plan participants did

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[2] The district court also invalidated an indemnification provision in the ESOP. Pet. App. 10a-11a. That issue is not before this Court.

not meet the definition of fiduciary, and consequently could not be "named fiduciaries" under 29 U.S.C. 1103(a)(1). Pet. App. 25a-26a. The court of appeals thus found that NationsBank could not have followed the plan's mirror voting provision if it conflicted with ERISA or its fiduciary duty provisions. *Id.* at 28a-29a. After concluding that the mirror voting provision "is not per se contrary to ERISA," the court of appeals remanded to the district court the factual questions whether NationsBank acted prudently and solely in the interest of plan participants. *Id.* at 29a-30a.

With respect to the allocated unvoted shares, the court of appeals reversed the district court's finding that plan participants were not named fiduciaries under ERISA. Pet. App. 30a-32a. The court of appeals therefore concluded that NationsBank "was not required to exercise its independent judgment in deciding how and whether to tender those shares," so long as NationsBank "ma[de] sure the participants' directions were proper, in accordance with the terms of the plan, and not contrary to ERISA" under 29 U.S.C. 1103(a)(1). Pet. App. 32a. Noting that the Secretary did not argue that the plan participants' directions conflicted with the terms of the plan or ERISA, the court of appeals remanded to the district court the factual question whether NationsBank's tender option notice to plan participants was adequate to allow the participants to give "proper directions" to NationsBank regarding their votes. *Ibid.* The court of appeals directed the district court to apply "the standard for proper directions that the Secretary has consistently espoused, and which both parties cite in this appeal." *Ibid.*

The court of appeals denied a petition for rehearing in a per curiam opinion. Pet. App. 1a-3a. The court found that a summary plan description that stated that participants' actions with respect to allocated shares would control the tendering of unallocated shares "is not enough to put the participants on notice that they were fiduciaries with regard to the unallocated shares." *Id.* at 2a. The court explained that "[t]he participants could not be fiduciaries with regard to the unallocated shares in the absence of explicit notice that they could be held liable for their actions with regard to the unallocated shares." *Id.* at 2a-3a.

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or any other court of appeals. Accordingly, further review is unwarranted.

1. a. Petitioners contend (Pet. 6-7) that, under 29 U.S.C. 1103(a)(1), the ESOP plan participants were named fiduciaries whose directions NationsBank was bound to follow with respect to the ESOP's unallocated shares pursuant to the plan's "mirror voting" provision. Petitioners also argue (Pet. 7-9) that, by concluding that the ESOP participants in this case were not named fiduciaries absent notice of their potential liability for breach of fiduciary duty, the court of appeals' decision creates a non-statutory requirement that plan participants cannot be named fiduciaries unless the participants are notified of their potential liability. Those contentions are without merit.

The court of appeals correctly construed the requisites for a named fiduciary under 29 U.S.C.

1103(a)(1). ERISA's definition of "fiduciary" includes the ability to exercise discretionary authority or control over the management or disposition of plan assets. 29 U.S.C. 1002(21)(A). Accordingly, the court determined that "[i]n order for a fiduciary to exercise discretion, the fiduciary must engage in conscious decision making or knowledgeable control over assets." Pet. App. 23a. Thus, the court properly found that, "[b]ased on the plain language of ERISA, ESOP participants are not fiduciaries when they do not knowingly decide how assets will be managed." *Ibid.* The court of appeals also properly found that, on the facts in this case, the summary plan description was insufficient to provide plan participants with adequate notice of their status as fiduciaries because the summary plan description did not notify plan participants that they could be held liable to third parties for their actions with respect to the unallocated shares. *Id.* at 2a-3a. As the court explained,

> if participants are named fiduciaries with regard to unallocated shares, as a result of their actions they may face risk of liability extending beyond loss of value in their own shares. NationsBank has pointed to nothing in ERISA that would bar co-participants, the ESOP itself, or the Secretary from suing participants when they make imprudent decisions with regard to unallocated shares.

Id. at 25a. The court correctly rejected NationsBank's position as "unacceptable, at least where participants are not adequately informed of the responsibilities they possess and the liability that could go hand in hand with those responsibilities." *Id.* at 25a-26a.

Petitioners are also incorrect in suggesting (Pet. 9) that the court of appeals' decision provides a basis for an individual trustee to defend against liability for breach of fiduciary duty on the ground that he has not received notice of his potential liability. The court of appeals limited its holding to "the circumstances of this case," in which an ESOP trustee attempts to avoid ERISA's fiduciary obligations on the ground that ESOP participants are named fiduciaries despite inadequate notice of their status. Pet. App. 27a.

b. Petitioners further argue (Pet. 11-14) that the court of appeals improperly adopted a "prudent person" standard instead of an "abuse of discretion" standard to govern the conduct of an ESOP trustee. That contention is without merit. Although ERISA exempts ESOPs from the Act's ten-percent limitation on plan ownership of employer stock and from the Act's diversification requirements, see 29 U.S.C. 1104(a)(2), 1107, ESOP fiduciaries are subject to the "[p]rudent man standard of care" applicable to all ERISA fiduciaries. 29 U.S.C. 1104(a). The court of appeals therefore correctly held that, because NationsBank was not a directed trustee under 29 U.S.C. 1103(a)(1), NationsBank's conduct was governed by ERISA's fiduciary standards, including the duty to act prudently and solely in the interest of plan participants. Pet. App. 28a-30a.

Contrary to petitioners' contention (Pet. 11-14), the court of appeals' decision does not conflict with *Moench* v. *Robertson*, 62 F.3d 553 (3d Cir. 1995), cert. denied, 516 U.S. 1115 (1996), and *Kuper* v. *Iovenko*, 66 F.3d 1447 (6th Cir. 1995). Those decisions concluded that an ESOP trustee's decision to invest in employer stock, instead of diversifying the plan's investments, is governed by an abuse of discretion standard. The

courts in *Moench* and *Kuper* reasoned that subjecting an ESOP fiduciary's investment decisions to a strict prudence standard of care was "inappropriate," because "such scrutiny 'would render meaningless the ERISA provision [29 U.S.C. 1104(a)(2)] excepting ESOPs from the duty to diversify.'" *Kuper*, 66 F.3d at 1458-1459 (quoting *Moench*, 62 F.3d at 570). In carving out a narrow exception to ERISA's general fiduciary duty of prudence, however, neither *Kuper* nor *Moench* held that all ESOP trustee decisions with respect to plan asset management are governed by an abuse of discretion standard. See *Moench*, 62 F.3d at 569 ("ESOPs are covered by ERISA's stringent requirements, and * * * ESOP fiduciaries must act in accordance with the duties of loyalty and care."). Thus, petitioners' attempt to exempt themselves from ERISA's command that fiduciaries prudently discharge their duties is without merit.

2. Petitioners further contend (Pet. 10-11) that, by remanding to the district court the issue of whether plan participants gave NationsBank "proper directions" under 29 U.S.C. 1103(a)(1) with respect to the allocated unvoted shares, the court of appeals' decision conflicts with the decisions of other courts of appeals. In support of that contention, petitioners cite authorities holding that a directed trustee has no duty to investigate the merits of a named fiduciary's directives. See *Maniace* v. *Commerce Bank*, 40 F.3d 264, 267-268 (8th Cir. 1994), cert. denied, 514 U.S. 1111 (1995); *Grindstaff* v. *Green*, 133 F.3d 416, 425-426 (6th Cir. 1988).[3] Those decisions, however, do not address

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[3] Petitioners also cite *Silverman* v. *Mutual Benefit Life Ins.*, 138 F.2d 98 (2d Cir. 1988). That decision, however, did not involve the duty of a directed trustee under 29 U.S.C. 1103(a)(1).

the interpretation of the requirement under 29 U.S.C. 1103(a)(1) that a directed trustee follow the "proper directions" of a named fiduciary and, accordingly, do not conflict with the court of appeals' decision in this case.[4]

In agreeing with NationsBank that it acted as a directed trustee with respect to the allocated unvoted shares, the court of appeals concluded that "NationsBank was not required to exercise its independent judgment in deciding how and whether to tender those shares." Pet. App. 32a. Instead, the court of appeals simply remanded the matter to the district court, based on a "standard * * * that the Secretary has consistently espoused, and which both parties cite," to determine whether the plan participants were given adequate information about the tender options and factual developments respecting those options, such that NationsBank received "proper directions" from plan participants. *Ibid.* That interlocutory and factbound decision does not warrant this Court's review.

3. Finally, petitioners contend (Pet. 14-16) that this Court should decide whether the Secretary's informational letter to Polaroid is entitled to deference when the Secretary invoked her deliberative

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The court in *Silverman* simply found that a discretionary trustee under 29 U.S.C. 1104(a)(1)(B) had no duty of inquiry when it disbursed plan funds to a plan trustee under the terms of the plan. 138 F.3d at 102-103.

[4] Petitioners also err in asserting (Pet. 11 n.8) that *FirstTier Bank* v. *Zeller*, 16 F.3d 907, 911 (8th Cir.), cert. denied, 513 U.S. 871 (1994), suggests the existence of a circuit conflict regarding the duties of directed trustees. As the Eighth Circuit explained, its decision in *Zeller* was distinguishable from its decision in *Maniace* on its facts. *Maniance*, 40 F.3d at 268.

process privilege during discovery. The court of appeals, however, accorded no such deference to the Secretary's letter in this case. In adopting the Secretary's argument that plan participants were not sufficiently informed to be named fiduciaries regarding the ESOP's unallocated shares, the court stated that the Secretary's position "is not entitled to deference" but nonetheless "coincides with [the court's] own view." Pet. App. 21a; see also *id*. at 3a, 21a, 26a n.11. (declining to reach the validity of the Secretary's position that plan participants could never be named fiduciaries with respect to such shares).[5] Accordingly, the question posed by petitioners is not presented in this case.

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[5] Similarly, the court rejected as "unreasonable" the Secretary's position that plan participants were not named fiduciaries with respect to the allocated unvoted shares, and remanded to the district court to "apply the standard for proper directions * * * which both parties cite in this appeal." Pet. App. 32a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General

MARVIN KRISLOV
Deputy Solicitor for National Operations

ALLEN H. FELDMAN
Associate Solicitor

NATHANIEL I. SPILLER
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