No. 02-593

In the Supreme Court of the United States

HALL HOLDING CO., INC., ET AL., PETITIONERS

v.

ELAINE L. CHAO, SECRETARY OF LABOR

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

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

The Employee Retirement Income Security Act (ERISA) prohibits a fiduciary from causing an employee benefit plan to engage in a transaction that the fiduciary knows or should know constitutes a sale or exchange of property between the plan and a party in interest. An exception to that rule allows the acquisition or sale by a plan of qualifying employer securities if the plan pays no more than "adequate consideration." When the employer securities are not publicly traded, "adequate consideration" means "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B). The question presented is:

Whether fiduciaries fail to pay "adequate consideration" for employer stock that is not publicly traded, where they fail to determine the fair market value of the stock in good faith and thereby cause losses to the plan.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-56a) is reported at 285 F.3d 415. The August 10, 1999, decision of the district court (Pet. App. 98a-116a) is reported at 60 F. Supp. 2d 755. The January 9, 1998, and March 10, 1998, decisions of the district court (Pet. App. 57a-78a, 79a-85a) are reported at 990 F. Supp. 955. The magistrate judge's report and recommended decision (Pet. App. 86a-97a) and the district court's August 10, 1999, order (Pet. App. 117a-118a) and post-judgment decisions (Pet. App. 119a-131a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on April 3, 2002. A petition for rehearing was denied on July 18, 2002. Pet. App. 132a. The petition for a writ of certiorari was filed on October 15, 2002. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Employee Retirement Income Security Act of 1974 (ERISA) requires the fiduciaries of an employee benefit plan to discharge their duties with respect to the plan solely in the interest of the plan's participants and beneficiaries and, among other things, with a high degree of prudence. 29 U.S.C. 1104(a)(1)(A), (B). ERISA also prohibits a fiduciary from engaging in certain prohibited transactions, including, among other things, a sale or exchange of property between a plan and a party in interest. 29 U.S.C. 1106(a)(1)(A).[1] ERISA's prohibited transaction provision "supplements the fiduciary's general duty of loyalty to the plan's beneficiaries [in 29 U.S.C. 1104(a)] by categorically barring certain transactions deemed 'likely to injure the pension plan.'" *Harris Trust & Sav. Bank* v. *Salomon Smith Barney Inc.*, 530 U.S. 238, 241-242 (2000) (citation omitted).

An employee stock ownership plan (ESOP) is an employee benefit plan that invests primarily in stock of the employer sponsoring the plan. See 29 U.S.C. 1107(d)(5), (6). Because such an employer is a party in interest, see 29 U.S.C. 1002(14)(C), the sale of employer stock to an ESOP would be prohibited under ERISA were it not for an exemption from the prohibitions in 29 U.S.C. 1106(a). That exemption allows an "acquisition or sale by a plan of qualifying employer securities" if, among other things, the acquisition or sale is for "ade-

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[1] A party in interest includes, among others, any employer whose employees are covered by a plan, and certain related corporate entities and owners. 29 U.S.C. 1002(14)(C), (E), (G).

quate consideration." 29 U.S.C. 1108(e)(1). For employer securities that have no recognized market, "adequate consideration" means, in relevant part, "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B).

If a fiduciary breaches his duties to a plan, he is "personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary." 29 U.S.C. 1109(a). The Secretary of Labor, among others, may sue to obtain such relief. 29 U.S.C. 1132(a)(2).

2. In 1988, petitioner Goldman Financial Group, Inc. (GFGI), acquired Hall Chemical Company, a company whose stock is not publicly traded. Pet. App. 4a; Pet. 5. In 1990, GFGI decided to create an ESOP for the employees of Hall Chemical. Pet. App. 60a; see *id.* at 4a-5a. The ESOP was to be "leveraged," which means that the ESOP, upon being established, would borrow money and then use the money to buy qualifying employer securities. *Id.* at 8a n.5, 60a. The ESOP was to repay the debt from cash contributions that Hall Chemical was to make on behalf of its employees. *Id.* at 8a n.5, 58a-59a.

Petitioners George Ahearn and Michael Shields were officers of Hall Chemical and the trustees of the Hall Chemical ESOP. Pet. App. 4a, 59a-60a, 62a. They had no input into the price the ESOP was to pay for the stock, however. *Id.* at 28a-31a, 75a. Petitioner Kathleen Keating made that decision in her capacity as a GFGI employee, subject to the approval of petitioner

David Goldman, who controlled GFGI and its subsidiaries. *Id.* at 6a-7a, 75a. Keating determined that the ESOP would pay $3.5 million, a price that Goldman accepted. *Id.* at 7a.

Keating explained that the $3.5 million purchase price was based on an expert's valuation of Hall Chemical Company. Pet. App. 5a-6a, 7a. That expert, James Cunningham, had valued Hall Chemical Company as worth between $32.4 and $37.4 million. *Id.* at 6a, 92a, 102a. Keating took the mid-point of that range ($34.9 million), multiplied it by the amount of stock to be purchased (9.9%), and then rounded *up* the result ($3.4551 million) so that the ESOP paid more than the midpoint. *Id.* at 6a-7a, 32a. Keating made no downward adjustments to the $3.5 million purchase price to reflect the fact that the ESOP was purchasing only a minority interest in a privately held company, adjustments that Cunningham testified that he would have made if he had been told that the ESOP was only purchasing a minority interest. *Id.* at 24a-25a, 111a. Keating also made no downward adjustment to Cunningham's valuation to reflect the fact that the ESOP did not actually purchase shares of Hall Chemical Company, the company that Cunningham had valued. Instead, the ESOP was purchasing shares of a GFGI subsidiary (Hall Holding Company) that in turn owned Hall Chemical. *Id.* at 8a. Hall Holding was worth less than Hall Chemical because it had liabilities and "negative accounts receivable" that Hall Chemical did not have. *Id.* at 93a, 112a-113a.

As a result of Keating's determinations, the ESOP obtained a loan for $3.5 million from other GFGI pension plans and used the loan proceeds to buy 110 shares, or 9.96%, of Hall Holding Company. Pet. App. 8a, 61a. The Secretary sued petitioners, alleging that petitioners were fiduciaries who had violated ERISA's prohibited transaction provision, 29 U.S.C. 1106(a)(1)(A), by having the ESOP buy stock for more than adequate consideration. Pet. App. 57a.

3. a. The district court initially denied the Secretary's motion for summary judgment on liability. Pet. App. 70a-78a. The court reasoned that the stock transaction would violate 29 U.S.C. 1106(a)(1) unless petitioners paid "adequate consideration" for it. Pet. App. 71a. The court concluded that a fiduciary does not pay "adequate consideration" unless the fiduciary, in determining the fair market value of the stock, complies with the general fiduciary requirements in 29 U.S.C. 1104(a), to act solely in the interest of plan participants and beneficiaries, for the exclusive purpose of providing them benefits, and as prudent persons would act under the circumstances. Pet. App. 71a-72a. Petitioners could not prove that they acted prudently in determining the fair market value of the stock purchased by the ESOP, the court reasoned, because none of them "was acting on behalf of the ESOP when it was determined how much the ESOP would pay for the Hall Holding stock." *Id.* at 75a.

The court also concluded, however, that a violation of 29 U.S.C. 1106(a)(1) does not occur unless petitioners' imprudence caused a loss to the plan. Pet. App. 76a. To decide whether a loss occurred, the court asked "whether an objective, reasonable fiduciary would have concluded, after conducting a prudent investigation, that $3.5 million was too high a price to pay for 110 shares of Hall Holding stock." *Ibid.* Because the parties' experts disagreed on the value of the stock, and because the court saw "probable flaws" in both experts' valuations, the court concluded that material factual disputes on the value of the stock precluded summary judgment. *Id.* at 77a-78a.

b. On reconsideration, the court concluded that, regardless of whether a loss occurred, petitioners violated 29 U.S.C. 1106(a)(1). Pet. App. 79a-85a. Instead, the court stated that "the issue of loss goes to the appropriate remedy," and that the court would consider that issue at trial. Pet. App. 84a. To assist the court in resolving that issue, the court referred the case to a magistrate judge for a recommendation on the fair market value of the Hall Holding stock purchased by the ESOP. See *id.* at 86a.

c. The magistrate judge recommended a finding that the Hall Holding stock was worth $2,731,174.75, or $768,825.25 less than the ESOP paid for it. Pet. App. 87a. The magistrate judge based his recommendation on the valuation of Hall Chemical by petitioners' expert (Cunningham), as adjusted to reflect: the ESOP's purchase of the less valuable Hall Holding, rather than Hall Chemical, stock; the fact that the ESOP was purchasing only a minority interest; and the fact that the ESOP was purchasing shares in a closely held company that were not readily marketable. *Id.* at 92a-94a.

d. The district court adopted the magistrate judge's recommendation concerning plan losses in part, rejected it in part, and found that the fair market value of the Hall Holding stock purchased by the ESOP was $2,450,451.00, or $1,049,549.00 less than the ESOP paid for it. Pet. App. 98a-118a. Like the magistrate judge, the district court accepted the valuation of Hall Chemical Company by petitioners' expert Cunningham as the starting point for the valuation. *Id.* at 105a. Rather than take the "approximate mid-point" of Cunningham's range of values ($32.4 million to $37.4 million), however, the district court took the lowest value of the range "to provide the ESOP members any benefit of the doubt on the valuation." *Id.* at 104a. The court also corrected a mathematical error of the magistrate judge, but otherwise accepted his recommended adjustments to Cunningham's valuation. *Id.* at 102a, 105a-113a.

The district court did not "refuse[] to consider evidence on what price a hypothetical prudent fiduciary would have paid for the Hall ESOP stock," as petitioners assert. Pet. 7. [2] The court considered petitioners' evidence but did not credit it as much as Cunningham's because the expert they proffered (Karen Brown) "did not actually value the stock of either Hall Holding or Hall Chemical," while Cunningham did. Pet. App. 105a; see also *id.* at 113a (Brown was admittedly "retained to discuss only Cunningham's methodologies, not whether his actual calculations were correct"). The court also effectively found that the fair market value of the stock ($2,450,451) was what a hypothetical prudent fiduciary, acting in accordance with ERISA's duty of loyalty to participants, would have paid for the stock. See *id.* at 100a (whether the court used "reasonable hypothetical fiduciary" standard or "objective value" standard for determining fair market value of the stock was "a

[2] Petitioners incorrectly assert that the magistrate judge "declined to consider the only evidence presented on what a hypothetical reasonable fiduciary would have paid." Pet. 7. That evidence came from Karen Brown, who testified on behalf of petitioners. See Pet. App. 104a. The magistrate judge considered Brown's testimony. See *id.* at 87a (noting that "[e]ach of the three major witnesses has strengths and weaknesses"; observing that of the three, "Brown is an expert in evaluating ESOPs," but "was not asked to render an opinion on the value of the Hall Holding minority interest held by the" ESOP, and concluding that therefore "[t]he testimony of each major witness was credited in part and not credited in part.").

distinction without a difference"); *id.* at 101a ("the fair market value of the stock and the value of the stock as determined by a reasonable hypothetical fiduciary *looking after the interests of the ESOP* (*i.e.*, not [petitioners]), should be the same").

4. In the court of appeals, petitioners argued that the district court erred by granting summary judgment when material factual disputes existed on the question of whether they violated their fiduciary duties and by holding them liable for a violation of 29 U.S.C. 1106(a)(1) without considering what a reasonable hypothetical fiduciary would have paid for the stock purchased by the ESOP. Pet. App. 17a-18a. Petitioners did not, however, challenge the district court's calculation of losses based on its determination of the stock's value. See Appellants' C.A. Br. 22-23, 43-50. Instead, they argued that the ESOP's participants were not harmed by the overpayments, that giving them the cash difference between the $3.5 million paid by the ESOP and the $2,450,451 fair market value of the stock would be to provide benefits the participants never earned or expected, and that the Internal Revenue Code barred such an award. *Id.* at 43-50; Pet. App. 51a-55a. The court of appeals rejected all of those arguments.[3]

a. The court concluded that no material issues of fact existed as to whether petitioners breached their fiduciary duties, for two reasons. Pet. App. 23a-33a. First, the court reasoned that a fiduciary cannot rely on an

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[3] The court of appeals also considered and rejected arguments that GFGI was not a proper party defendant and that petitioners Hall Holding and Goldman were not fiduciaries. Pet. App. 18a-23a. Petitioners do not challenge the court's decision on those issues.

expert's valuation of a company unless the fiduciary, among other things, gives the expert complete and accurate information and makes certain that reliance on the expert's advice is reasonably justified under the circumstances. *Id.* at 25a-26a. Petitioners failed to do either, the court reasoned. *Id.* at 26a-27a. The court also concluded that petitioners had committed "clear violations" of their fiduciary duties by the "uniquely careless and haphazard manner in which the Hall Chemical ESOP was created." *Id.* at 32a. In particular, the court noted that the ESOP's trustees were not involved in setting the price the ESOP would pay for the stock it purchased, and that the person primarily involved in setting the price (petitioner Keating) used a valuation of the wrong company, charged the ESOP extra by rounding up the purchase price, and otherwise failed to act in the interests of the ESOP. *Id.* at 28a-33a.

b. Based on statutory language, the court of appeals concluded that petitioners violated 29 U.S.C. 1106(a)(1)(A) because, whether or not a "hypothetical reasonable fiduciary" would have paid as much, "defendants did not make a good faith determination as to the price of the Hall Holding stock." Pet. App. 40a; see generally *id.* at 33a-51a. The court reasoned that 29 U.S.C. 1106(a)(1) prohibits transactions in which an employee benefit plan purchases stock from an employer, that the exception to this prohibition in 29 U.S.C. 1108(e) applies only if the purchase is for "adequate consideration," and that "adequate consideration" in the case of a closely held corporation such as Hall Holding is defined by 29 U.S.C. 1002(18)(B) to mean "the fair market value of the asset as determined in good faith by the trustee." Pet. App. 38a. The definition of "adequate consideration" thus has "two distinct parts," the court reasoned: "First, there is the 'fair market value' part, then there is the 'as determined in good faith by the trustee' part." *Ibid.* Because petitioners did not engage in a good faith determination of fair market value, the court concluded that they did not pay "adequate consideration" under the ERISA definition of that term. *Id.* at 40a-41a.

Accordingly, the court rejected the position of the Eighth Circuit majority in *Herman* v. *Mercantile Bank, N.A.*, 143 F.3d 419 (1998). Pet. App. 34a-38a. In *Mercantile Bank*, the court concluded that "[e]ven if a trustee fails to make a good faith effort to determine the fair market value of the stock, 'he is insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway.'" 143 F.3d at 421 (citation omitted). The Sixth Circuit in this case rejected that analysis because it "gives no weight to the good faith determination under [29 U.S.C. 1002(18)(B)]." Pet. App. 38a.

The court of appeals also rejected petitioners' argument that the Secretary had to prove that a fiduciary violation caused harm to the plan to establish an ERISA violation. It explained that 29 U.S.C. 1106(a)(1) creates categories of per se violations requiring no proof of harm to the plan. Pet. App. 43a-44a. Accordingly, the court distinguished its earlier decision in *Kuper* v. *Iovenko*, 66 F.3d 1447 (6th Cir. 1995), which held that ESOP fiduciaries did not violate ERISA's prudence requirement, 29 U.S.C. 1104(a)(1)(B), by continuing to hold employer securities, where the plaintiffs had failed to prove that a reasonable fiduciary would have sold the stock and diversified into other investments. Pet. App. 41a-43a. Because *Kuper* considered only a violation of 29 U.S.C. 1104, it does not require reading a causation element into 29 U.S.C. 1106, the court stated, "and such a reading is far beyond the scope of the issues presented in that case." Pet. App. 43a.

c. Having determined liability, the court rejected petitioners' challenge to the district court's monetary award because their arguments were "based upon faulty premises" and lacked "any authority for their claims." Pet. App. 51a. As discussed above, petitioners argued that when the ESOP paid $3.5 million for stock worth $2,450,451, the ESOP and its participants were not harmed. The court of appeals explained that the overpayment did harm the ESOP and its participants because the ESOP incurred more debt than it should have incurred and therefore the participants had to wait longer to become fully vested in the stock and received a smaller return on the stock than they should have received. *Id.* at 52a-55a. Petitioners also argued that giving participants the amount of the overpayment ($1,049,549, plus interest) would constitute benefits that the participants never earned or expected or could legally obtain under the Internal Revenue Code. *Id.* at 55a. It "is simply not true" that the benefits were not earned, the court stated, because "benefits such as an ESOP are not a gratuity . . . but a form of deferred wages." *Id.* at 55a (internal quotation marks omitted). The court added that petitioners had provided no authority to show that the Internal Revenue Code prohibited an award within the district court's wide latitude to remedy ERISA breaches of fiduciary duty. *Id.* at 55a-56a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court. Although the decision below disagreed with the analysis the Eighth Circuit used in *Herman* v. *Mercantile Bank, N.A.*, 143 F.3d 419 (1998), the result in this case would be the same under either analysis, making further review of the asserted circuit conflict unnecessary. Petitioners' other asserted conflicts do not exist. The decision below also creates none of the "dangerous uncertainty in the area of ESOP jurisprudence" that petitioners posit. Pet. 18. Further review by this Court therefore is not warranted.

1. The court of appeals correctly concluded that petitioners violated ERISA in purchasing the Hall Holding stock for $3.5 million on behalf of the ESOP. As discussed above, the court followed a three-step analysis. First, the court concluded that petitioners had not engaged in a good faith investigation into the fair market value of the Hall Holding stock purchased by the ESOP. Second, the court concluded that the stock purchase was therefore a prohibited transaction under 29 U.S.C. 1106(a)(1)(A) because petitioners' failure to investigate in good faith meant that the stock purchase was not for "adequate consideration," as required for petitioners to obtain an exemption from Section 1106(a)(1)(A). Third, the court upheld the district court's calculation of plan losses caused by petitioners' violation of ERISA because petitioners did not challenge those calculations but instead made arguments that "would confound any rational investor," Pet. App. 52a, were "baffling," *id.* at 53a, and "simply not true." *Id.* at 55a.

The court of appeals' analysis is correct. Section 1106(a)(1) of ERISA "categorically bar[s] certain transactions deemed 'likely to injure the pension plan.'" *Harris Trust & Sav. Bank* v. *Salomon Smith Barney Inc.*, 530 U.S. 238, 241-242 (2000) (citation omitted). The sale of stock between the ESOP and Hall Holding

Company is one such transaction because Hall Holding is a party in interest to the ESOP, see 29 U.S.C. 1002(14)(C), (E), and prohibited transactions include a "sale or exchange * * * of any property between the plan and a party in interest." 29 U.S.C. 1106(a)(1)(A). Thus, ERISA prohibited the stock sale unless an exemption permitted it.

The exemption at issue here, the terms of which the court decided were not satisfied, permits an "acquisition or sale by a plan of qualifying employer securities" if, among other things, the acquisition or sale is for "adequate consideration." 29 U.S.C. 1108(e)(1). For stock that is not publicly traded, such as the Hall Holding stock, "adequate consideration" means, in relevant part, "the fair market value of the asset as determined in good faith by the trustee or named fiduciary." 29 U.S.C. 1002(18)(B).

The definition of "adequate consideration" therefore requires two things, as the court said: fair market value, and "good faith by the trustee or named fiduciary" in making the determination of fair market value. Petitioners failed to establish that the "good faith" requirement had been met, both because the trustees of the ESOP had no input into the price the ESOP was to pay for the stock and because the persons who did determine the price were not acting in the interests of the ESOP and did not provide their expert with all the information he needed to make a proper evaluation. Pet. App. 25a-26a, 28a-33a, 75a-76a. Accordingly, petitioners failed to establish that the stock sale was exempt from 29 U.S.C. 1106(a)(1)(A)'s prohibition on such sales.

Petitioners do not dispute that they failed to undertake a good faith investigation into the fair market value of the stock purchased by the ESOP. Nor do they challenge the court's calculation of losses to the ESOP. Instead, they argue that because valuation professionals may not reach the same conclusion as to the value of stock in a closely-held company, the test for "adequate consideration" should be deemed satisfied if the price an ESOP fiduciary pays for such stock is "objectively reasonable—that is, consistent with what a hypothetical prudent fiduciary would pay." Pet. 20. Petitioners assert that, if that test is satisfied, "there is no prohibited transaction, no loss to the plan, and no monetary damages may be assessed against the fiduciary even if its investigation was imperfect in some manner." Pet. 21.

Petitioners' arguments are incorrect. First, petitioners overlook the fact that the amount they paid was *not* objectively reasonable. Second, although valuation of a closely-held company is an inexact science, that is not a reason to disregard the statutory definition of "adequate consideration," which requires more than a determination of fair market value. That definition also includes a requirement that the plan's fiduciaries conduct a good faith investigation because such an investigation ensures that, despite uncertainties as to the stock's value, the fiduciary has attempted to get the best possible price for the ESOP. Eliminating the good faith requirement would allow fiduciaries to do what petitioners did here: They could act on behalf of the seller rather than on behalf of the ESOP, and charge the ESOP extra by rounding up numbers. See Pet. App. 33a. They could also rely on a valuation that, because it omitted factors that lowered the value of the stock that was acquired, "it is difficult to believe that any prudent person would use." *Ibid.* Breaching fiduciaries should not be allowed to argue that the losses found by the court to have been caused by their errors should be excused because some "hypothetical prudent fiduciary" might have reached the same result.

Indeed, courts have held the prudence standard to be violated where the fiduciary failed to conduct an adequate investigation even if, unlike here, that conduct caused no loss to the plan. In that circumstance, the fiduciary may still be liable for "appropriate injunctive relief such as removing the offending trustees from their positions." *Brock* v. *Robbins*, 830 F.2d 640, 647 (7th Cir. 1987); *Fink* v. *National Sav. & Trust Co.*, 772 F.2d 951, 961, 962 (D.C. Cir. 1985) (Scalia, J., concurring) ("[b]reach of the fiduciary duty to investigate and evaluate would sustain an action to enjoin or remove the trustee," but would "not sustain an action for the damages arising from losing investments"); see 29 U.S.C. 1109(a) (remedies for breach of fiduciary duty include "such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary").

For those reasons, petitioners err in suggesting that proof of loss must be shown to establish a violation of 29 U.S.C. 1106. Furthermore, petitioners are incorrect in arguing that "[t]he only evidence in this case concerning causation was that the price paid by the Hall ESOP fiduciaries was well within the range of value that a hypothetical prudent fiduciary would have paid." Pet. 21. There was ample evidence to the contrary, which the district court credited in determining plan losses. See Pet. App. 104a-114a. The district court also effectively found that the fair market value of the stock ($2,450,451) was what a hypothetical prudent fiduciary would have paid for the stock. See *id.* at 100a (whether the court used "reasonable hypothetical fiduciary" standard or "objective value" standard for determining fair market value of the stock was "a distinction without a difference"); *id.* at 101a (fair market value "should be the same" as the value of the stock "determined by a reasonable hypothetical fiduciary *looking after the interests of the ESOP*"). Thus, there is no merit to petitioners' argument that the court of appeals "concluded that the Hall ESOP suffered a loss simply because the District Court determined a lower value for the Hall Holding stock than did Petitioners (or the hypothetical prudent fiduciary or, for that matter, the Magistrate Judge)." Pet. 8-9.

2. a. Petitioners argue that review should be granted because the decision below conflicts with the Eighth Circuit's decision in *Mercantile Bank*. Pet. 9, 11-13. There is some tension between the treatment of the "hypothetical prudent fiduciary" in the decision below and in *Mercantile Bank*. That tension, however, is irrelevant to the result in this case and does not amount to a conflict in the courts of appeals warranting this Court's review.

In *Mercantile Bank*, the Secretary alleged that a fiduciary had violated ERISA by failing adequately to investigate the value of closely-held stock and by purchasing the stock for more than its fair market value. 143 F.3d at 421. The district court found no violation because "the fair market value of the stock, whatever it was precisely, was sufficiently close to what [the fiduciary] paid that, even if [the fiduciary] did overpay slightly, [the fiduciary] had no reason to know that he was overpaying." *Id.* at 422. In affirming the district court, the Eighth Circuit reasoned that, although an ESOP may purchase stock only for "adequate consideration," a trustee who fails to make a good faith effort to determine the fair market value of the stock is "insulated from liability if a hypothetical prudent fiduciary would have made the same decision anyway." *Id.* at 421 (quoting *Roth* v. *Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 919 (8th Cir. 1994)). Construing the district court's decision in that case to have found that a hypothetical prudent fiduciary "could have and would have paid what [the actual fiduciary] paid for the stock," and reviewing that finding for clear error, the Eighth Circuit affirmed the district court's decision. *Id.* at 422.

In the instant case, the court of appeals disagreed with the Eighth Circuit's view that the statutory requirement of "adequate consideration" is satisfied regardless of the fiduciary's good faith so long as a hypothetical prudent fiduciary "would have made the same decision anyway." Pet. App. 36a (citations omitted). The court of appeals, however, did not disturb the district court's finding that petitioners' conduct caused losses to the ESOP because a "hypothetical prudent fiduciary" would not have paid as much for the company's stock. Thus, the court of appeals' rejection of the "hypothetical prudent fiduciary" standard in determining whether petitioners violated ERISA is irrelevant to the result in this case; whether that standard was applied, as in *Mercantile Bank*, as a touchstone in determining the existence of an ERISA violation, or, as here, in determining whether the plan incurred losses from the violation, the result would be the same: petitioners would be liable for a fiduciary breach and have to pay for $1,049,549 in plan losses.

Accordingly, although the difference between the Sixth and Eighth Circuits could be of significance in a case in which there is no proof of loss and the only remedy sought is the removal of the fiduciary, it has no significance in a case like this, in which there is concrete proof of loss. In a case such as this, both courts would agree that there was a violation of ERISA, that damage occurred, and that the fiduciary is liable for damages to make good to the plan for the loss. See *Mercantile Bank*, 143 F.3d at 421-422; *id.* at 423-428 (Bright, J., dissenting). Accordingly, further review in this case to resolve the differing analyses applied by the Sixth and Eighth Circuits would be unwarranted.

b. Petitioners also argue that the decision below conflicts with the Seventh Circuit's decision in *Robbins*. That is incorrect, because *Robbins* did not decide the issue presented here and in fact supports the decision below.

In *Robbins*, fiduciaries failed properly to investigate an insurance contract they obtained for an ERISA plan. 830 F.2d at 642, 646. The Secretary alleged that they violated ERISA's prudence requirement, 29 U.S.C. 1104(a)(1)(B), as well as a prohibited-transaction provision that forbids "furnishing of goods, services, or facilities between the plan and a party in interest," 29 U.S.C. 1106(a)(1)(C). *Robbins*, 830 F.2d at 643-644. The district court concluded that the Secretary failed to establish either violation because the fees paid by the plan for the contract were objectively reasonable and the plan suffered no losses. *Id.* at 645. "In essence, the district court concluded that if a trustee enters into a contract with a fee provision with which a hypothetical prudent trustee would also agree, then the trustee does not violate his duties under ERISA even if, when entering into the contract, the trustee has no idea whether or not the provision of the contract is reasonable." *Id.* at 646.

The court of appeals in *Robbins* affirmed the finding that there had been no prohibited transaction. *Robbins*, 830 F.2d at 644-645. The court relied on an exemption from the prohibited transaction provision at issue in that case, for "reasonable arrangements with a party in interest for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor." *Id.* at 644 (quoting 29 U.S.C. 1108(b)(2)). Because the court of appeals agreed with the district court that the fees paid under the contract were objectively reasonable, it held that the fiduciaries could rely on that exemption. 830 F.2d at 644-645.

The court of appeals in *Robbins*, however, reversed the district court's conclusion that the fiduciaries had not violated ERISA's prudence requirement. *Robbins*, 830 F.2d at 646-648. The court agreed with the district court that "[i]f trustees act imprudently, but not dishonestly, they should not have to pay a monetary penalty for their imprudent judgment so long as it does not result in a loss to the Fund." *Id.* at 647. But, quite logically, it held that they could be liable for appropriate equitable relief even if there was no monetary loss as a result of the imprudence. *Id.* at 647-648.

The holding in *Robbins* on the prohibited-transaction issue creates no conflict with the decision below because the court in *Robbins* construed a materially different ERISA exemption. The provision at issue in *Robbins* allows contracts between a plan and a party in interest "if no more than reasonable compensation is paid therefor." 29 U.S.C. 1108(b)(2). That provision has no requirement that reasonableness be determined in good faith by the fiduciary. The "adequate consideration" provision at issue here has such a good faith requirement. See 29 U.S.C. 1002(18)(B). The Seventh Circuit's interpretation of the service provider exemption in 29 U.S.C. 1108(b)(2) is thus entirely consistent with the Sixth Circuit's interpretation of the "adequate consideration" definition in 29 U.S.C. 1002(18)(B).

Moreover, the Seventh Circuit's holding in *Robbins* on the prudence issue supports the Sixth Circuit's decision here. Both courts held that the "hypothetical prudent fiduciary" concept is not a defense to liability under ERISA, even if it may be relevant in assessing plan losses.

c. Petitioners also argue that the court of appeals construed 29 U.S.C. 1106(a) not to have a causation requirement, and that the decision below therefore conflicts with appellate decisions requiring proof of causation of loss to a plan as a prerequisite to imposing monetary liability on an ERISA fiduciary for violations of 29 U.S.C. 1104. Pet. 10, 15-18. In their view, the court below departed from those cases by construing the prohibited transactions in 29 U.S.C. 1106(a) "to be 'per se' violations of ERISA as to which liability for monetary damages may be established in the absence of causation," Pet. 16, and created a conflict with *Donovan* v. *Cunningham*, 716 F.2d 1455 (5th Cir. 1983), cert. denied, 467 U.S. 1251 (1984), and *Robbins* because those cases require that 29 U.S.C. 1106(a) be construed the same way as 29 U.S.C. 1104(a). Pet. 10, 17-18.

Petitioners' premise—that the court below allowed liability for monetary damages to be imposed in the absence of causation—is incorrect. As discussed above, the court held first that a showing of "causation" is not required to establish a violation under 29 U.S.C. 1106(a). Pet. App. 41a-44a. Addressing monetary liability, however, the court then went on to consider and reject petitioners' attempt to establish that the violation caused no harm to the ESOP or its participants. *Id.* at 51a-56a. The court thus found that losses had been caused by the breach and measured the damages accordingly. The court's decision is therefore consistent with decisions of other courts of appeals that have imposed monetary liability on a fiduciary only for plan losses caused by a breach of the fiduciary's duty under various ERISA provisions.[4]

Moreover, neither *Robbins* nor *Cunningham* held that cases under 29 U.S.C. 1106(a) must be analyzed the same way as cases under 29 U.S.C. 1104(a). Petitioners' quotation from *Robbins* for that proposition is in fact a summary of the district court's reasoning in *Robbins*, which the Seventh Circuit rejected. See *Robbins*, 830 F.2d at 644 (quoted passage), 647-648 (Seventh Circuit holding that fiduciaries violated 29 U.S.C. 1104(a) even though they did not violate 29 U.S.C. 1106(a)). In *Cunningham*, the Fifth Circuit held that a fiduciary's obligation under 29 U.S.C. 1104(a) to act prudently is incorporated into the "good faith" part of the definition of "adequate consideration" in 29 U.S.C. 1002(18)(B). 716 F.2d at 1466-1468. The court did not hold, as petitioners appear to assume, that the prohibited transaction provisions should incorporate a loss-causation requirement from 29 U.S.C. 1104(a).

3. Finally, the court's decision in this case creates no "dangerous uncertainty in the area of ESOP jurisprudence." Pet. 18. Decisions of other courts of appeals have made clear to ESOP fiduciaries many of the requirements for valuing stock in a closely held company.

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[4] See Pet. 15 n.4 (citing *Silverman* v. *Mutual Ben. Life Ins. Co.*, 138 F.3d 98, 104 (2d Cir.), cert. denied, 525 U.S. 876 (1998); *In re Unisys Sav. Plan Litig.*, 74 F.3d 420, 445 (3d Cir.), cert. denied, 519 U.S. 810 (1996); *Elmore* v. *Cone Mills Corp.*, 23 F.3d 855, 864 (4th Cir. 1994) (en banc); *Physicians Healthchoice, Inc.* v. *Trustees of Auto. Employee Ben. Trust*, 988 F.2d 53 (8th Cir. 1993); *Diduck* v. *Kaszycki & Sons Contractors, Inc.*, 974 F.2d 270, 279 (2d Cir. 1992); *Ironworkers Local No. 272* v. *Bowen*, 695 F.2d 531, 536 (11th Cir. 1983); *Cosgrove* v. *Circle K Corp.*, 915 F. Supp. 1050, 1066 (D. Ariz. 1995), aff'd, 107 F.3d 877 (9th Cir. 1997) (Table)).

See, *e.g.*, *Howard* v. *Shay*, 100 F.3d 1484, 1489 (9th Cir. 1996), cert. denied, 520 U.S. 1237 (1997); *Cunningham*, 716 F.2d at 1467-1468; see also *Reich* v. *Valley Nat'l Bank*, 837 F. Supp. 1259, 1272 (S.D.N.Y. 1993). The court below followed those decisions. See Pet. App. 25a-26a (adopting requirements, set out in *Howard*, that an ESOP fiduciary must follow when relying on an expert's valuation); *id.* at 39a-40a (following *Cunningham* and *Valley National Bank*, and plain statutory language, in requiring a fiduciary to undertake a good faith determination of fair market value).

Nothing in the court's decision changes the rule, recognized by the Department of Labor, that ESOP fiduciaries receive "some leeway in the area of ESOP valuations." Pet. 20; see 53 Fed. Reg. 17,632, 17,633 (1988).[5] That leeway applies, however, only to fiduciaries who act in good faith, *i.e.*, those who undertake a prudent and independent investigation in valuing the stock of a closely-held company. Pet. 20 Where, as here, fiduciaries fail to act in good faith, they are entitled to less latitude.

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[5] As petitioners note (Pet. 19 n.6) the Department proposed a regulation that was never finalized. Nevertheless, the proposed regulation "is widely considered and followed." *Montgomery* v. *Aetna Plywood, Inc.*, 39 F. Supp. 2d 915, 919 n.1 (N.D. Ill. 1998).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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