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Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(k) Plan Participants

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It is the part of a wise man to keep himself today for tomorrow, and not to venture all his eggs in one basket.

—Miguel de Cervantes Saavedra.[1]

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[1] JOHN BARTLETT, FAMILIAR QUOTATIONS 972 (10th ed. 1919), http://www.bartleby.com/100/pages/page972.html.

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INTRODUCTION

Diversification is a cornerstone principle of prudent investment practices.[2] It is also a foundational principle of federally regulated, tax-subsidized retirement plans.[3] Yet, the importance of diversification is being lost on Congress. By failing to enact pension reform that restricts 401(k) plan investment in employer securities ("company stock"), Congress continues to jeopardize the retirement security of twenty-three million of the nation's forty-two million 401(k) plan participants who have access to a company stock investment alternative.[4]

Employers' unfettered ability to offer company stock as a 401(k) plan investment alternative can have a devastating effect on American workers' retirement security. Enron Corporation ("Enron"), once the seventh-largest business firm with over $100 billion in annual revenues,[5] provides the most

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[2] Zvi Bodie & Dwight B. Crane, Personal Investing: Advice, Theory and Evidence from a Survey of TIAA-CREF Participants 5 (May 28, 1997) (unpublished manuscript, available at http://papers.ssrn.com/sol3?delivery.cfm/9706193.pdf?absstractid=36158) (summarizing six generally accepted investment principles, including the principle that "[a]ll investors should diversify their total portfolio across asset classes, and the equity portion should be well-diversified across industries and companies").

[3] Alicia H. Munnell & Annika Sunden, *401(K)s and Company Stock: How Can We Encourage Diversification?*, ISSUES IN BRIEF (Ctr. for Retirement Research, Chestnut Hill, Mass.), July 2002, at 2, http://www.bc.edu/centers/crr/issues/ib_9.pdf.

[4] *See* OLIVIA S. MITCHELL & STEPHEN P. UTKUS, THE ROLE OF COMPANY STOCK IN DEFINED CONTRIBUTION PLANS 13 (Nat'l Bureau of Econ. Research, Working Paper No. 9250, Oct. 2002), *at* http://papers.nber.org/papers/w9250.pdf. Mitchell and Utkus explain why over half of 401(k) participants are affected:

> [O]nly 3 percent of 401(k) plans actually offer company stock as an investment option. . . . Yet because these plans are mainly sponsored by large firms, they account for a substantial subset of the DC [defined contribution] plan participant and asset universe. Consequently, those firms offering company stock include 42 percent of all DC plan participants and 59 percent of all DC plan assets. To put it differently, only 3 percent of 401(k) plans offer company stock, but some 23 million DC plan participants have access to company stock within their employer plans, and those DC plans command assets of $1.2 trillion, in total.

Id.

[5] *See* Allan Sloan & Michael Iskoff, *The Enron Effect: As the Accounting Scandal Spreads, Regulators and Politicians Are Pounding the Table for Reform. But Will Anything Really Change?*, NEWSWEEK, Jan. 28, 2002, at 34 ("The key to the Enron mess is that the company was allowed to give misleading financial

visible example. Its corporate shenanigans led to a dramatic decline in company stock value that left Enron employees facing unemployment with more than $1 billion in 401(k) plan losses attributable to company stock holdings.[6]

Like most large, publicly traded companies, Enron sponsored a 401(k) plan ("Enron 401(k) Plan")[7] with a company stock investment alternative.[8] Over 20,000 Enron 401(k) Plan participants directed their employee elective deferral contributions into any one of twenty employer-selected investment alternatives,[9] including mutual funds, a Schwab account that

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information to the world for years. Those fictional figures, showing nicely rising profits, enabled Enron to become the nation's seventh largest company, with $100 billion of annual revenues.").

[6] *The Enron Collapse and Its Implications for Worker Retirement Security: Hearings Before the House Comm. on Education and the Workforce*, 107th Cong. 25 (2002) [hereinafter *Hearings on the Enron Collapse*] (statement of Rep. Rush D. Holt, Member, House Comm. on Education and the Workforce).

[7] *Id.* at 214 (Enron Corporation Savings Plan, as amended and restated, effective July 1, 1999, Appendix G) [hereinafter *Plan*].

[8] *See* Patrick J. Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, CRS Rpt. for Cong., 107th Cong. at 3 (Jan. 23, 2002) [hereinafter Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*], *at* http://www.ieeeusa.org/forum/issues/reports/enronpension.pdf (55% of plans sponsored by large, publicly traded companies offer company stock as an investment option); Jack L. VanDerhi, *EBRI [Employee Benefit Research Institute] Special Report: Company Stock in 401(k) Plans: Results of a Survey of ISCEBS Members*, EMP. BENEFIT RES. INST. 3-4 (Jan. 31, 2002), http://www.ebri.org/pdfs/iscebs.pdf [hereinafter *EBRI Special Report: Company Stock in 401(k) Plans*] (survey of 3346 members of the International Society of Certified Employee Benefit Specialists found that 48% of respondents reported a company stock investment option in their client's/ employer's 401(k)plan, with large plans much more likely to offer a company stock investment alternative—73% compared to 32% for small plans); Profit Sharing/ 401(k) Council of America, *Company Stock 2002: Examining Company Stock in Profit Sharing/401(k) Plans*, tbl.2, at http://www.psca.org/data/compstock2002.asp (last visited Oct. 25, 2003) (also on file with author) [hereinafter PSCA, *Company Stock 2002*] (76.7% of respondent plans with 5000 or more plan participants offered company stock as an investment alternative, compared to 54.7% of respondent plans with 500 to 4999 plan participants and 13.5% of respondent plans with less than 500 plan participants offering company stock as an investment option).

[9] *Hearings on the Enron Collapse*, *supra* note 6, at 103 (statement of Cindy K. Olson, Executive Vice President, Human Resources and Community Relations, Enron Corporation).

was similar to a self-directed brokerage account,[10] and an Enron company stock fund account ("Enron company stock").[11]

Like most American workers who participate in 401(k) plans, Enron 401(k) Plan participants did not receive independent, individually-tailored investment advice.[12] What they did receive, however, was direct and indirect encouragement from Enron company executives to invest their employee elective deferral contributions in Enron company stock. Enron provided direct encouragement through its executives' vigorous support of the company's future profitability.[13] Indirect encouragement came in the

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[10] *See* Press Release, Hewitt Associates, *Hewitt Study Shows Employee Demand as Driving Force Behind Self-Directed Brokerage Accounts* (Mar. 12, 2001), *at* http://www.hewittasia.com./ep/resource/newsroom/pressrel/2001/03-12-01.htm [hereinafter Hewitt Associates, *Self-Directed Brokerage Accounts*] (defining "self-directed brokerage account" as "a 401(k) investment option that allows [plan] participants to maintain some or all [of their] assets in a separate individual brokerage account for the purpose of holding individual stocks, bonds or mutual funds that are not offered as part of the plan's main investment options.").

[11] *Hearings on the Enron Collapse*, *supra* note 6, at 104 (statement of Mike Rath, Benefits Manager, Enron Corporation).

[12] *See id.* at 8 (statement of Elaine L. Chao, Secretary, United States Department of Labor).

[13] *Id.* at 182 (testimony of Thomas O. Padgett, Senior Lab Analyst at EOTT (an Enron Subsidiary)) ("Through my time with Enron, the top management of the company constantly encouraged us to invest our savings in Enron stock. I took the fact that the Company matched our savings only with Enron stock as a further endorsement of the stock as a safe retirement investment. More recent statements made by Enron's top management, including e-mails from Ken Lay, about the Company's stock also caused me to keep investing my savings into the stock. I remember, in the Fall of 2000, Enron's top executives telling us at an employee meeting and by Company e-mail that Enron's stock price was going to increase to at least $120 per share. When Mr. Skilling resigned last August [2001], Mr. Lay told us that the Company was stronger than it had ever been."); *see also* STAFF OF J. COMM. ON TAXATION, 108TH CONG., REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS 537 (Comm. Print 2003), http://www.house.gov/jct/s-3-03-vol1.pdf [hereinafter JOINT COMM. ON TAXATION, REPORT OF INVESTIGATION OF ENRON] ("Even as the price of Enron stock declined during 2001, management told employees of a bright future for Enron. For example, Mr. Lay was optimistic in his predictions for the future of Enron stock, even when an employee specifically asked him about Enron stock in the context of the Enron Savings Plan. Similarly, Enron's Executive Vice President for Human Resources and Community Relations, Cindy Olson, said that employees should

form of plan fiduciaries' unwavering decisions to offer company stock as an investment alternative and make employer matching contributions in the form of Enron company stock.[14] This encouragement continued amid almost daily disclosures about Enron's worsening financial condition and questionable accounting practices, including reports that Enron had lost $618 million and written down $1.2 billion of its net worth due to off-balance-sheet partnerships.[15] Despite these reports, which led to Enron company stock plummeting from a January 2001 high of more than $80 a share to a January 2002 low of less than $1 per share,[16] Enron 401(k) Plan participants responded to employer encouragement by collectively investing more than 60% of their 401(k) plan assets in Enron company stock, with only 11% of the plan's Enron company stock concentration attributable to employer matching contributions.[17]

To make matters worse, Enron executives cashed in stock options and sold stock in equity compensation plans valued at approximately $128 million[18] while Enron 401(k) Plan participants were unable to diversify their company stock holdings. In October of 2001, Enron plan fiduciaries

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'Absolutely!' invest their contributions to the Enron Savings Plan in Enron stock.").

[14] *See generally Hearings on the Enron Collapse*, *supra* note 6, at 226 (Enron Corporation Savings Plan).

[15] *Id.* at 299 (Memorandum from Sherron Watkins to Mr. Lay) (questioning Enron's "aggressive" accounting and voicing concern that partnership deals would "implode in a wave of accounting scandals"); Gretchen Morgenson, *A Bubble No One Wanted to Pop*, N.Y. TIMES, Jan. 14, 2002, at A1, 2002 WL 8718684 (on October 16, 2001, Enron disclosed "that it had lost $618 million in the most recent quarter and that because earlier financial statements had been inaccurate, it was looping $1.2 billion of its net worth."); JOINT COMM. ON TAXATION, REPORT OF INVESTIGATION OF ENRON, *supra* note 13, at 537.

[16] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 1; *see also Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans*, DC PLAN INVESTING, Dec. 11, 2001, at 3.

[17] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 3. These numbers are accurate as of Dec. 21, 2000. *Id.*

[18] Ellen E. Schultz & Theo Francis, *Accounting for Enron: Enron Pensions Had More Room at the Top*, WALL ST. J., Jan. 23, 2002, at A4, 2002 WL-WSJ 3383703 ("At the same time that employees were locked into much of the Enron stock in their 401(k) plans, executives last year sold shares valued at about $128 million, on top of $486 million in sales in 2000, according to Thomson Financial/Lancer Analytics, which tracks insider transactions. Mr. Lay alone sold shares valued at $29.8 million during that period.").

implemented a scheduled blackout[19] to accommodate a change in Enron's third-party plan administrator.[20] During the blackout period in which Enron 401(k) Plan participants were restricted from changing investment allocations in their accounts,[21] Enron company stock lost an additional 35% of its then fair market value.[22] Shortly after the blackout restrictions were lifted, Enron filed for what was then the largest bankruptcy in U.S. history, leaving Enron 401(k) Plan participants with irretrievable losses.[23]

Unfortunately, Enron was not an isolated incident. During the longest bull market in U.S. history, millions of American workers responded to their employers' direct and indirect encouragement by investing a significant portion of their 401(k) plan assets in company stock. Less than 8 months following the demise of Enron, WorldCom executives were led away in handcuffs for allegedly fraudulent accounting practices that underreported over $7 billion in expenses.[24] That corporate scandal left WorldCom employees facing unemployment with over $1.1 billion in

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[19] *See* ERISA § 101(i)(7)(A), 29 U.S.C. § 1021(i)(7)(A) (2003), *amended by* Sarbanes-Oxley Act of 2002, § 306, 15 U.S.C.A. § 7244 (2002) (defining a blackout period as any period of three or more consecutive business days during which the ability of participants in an individual account plan to "direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited or restricted").

[20] *See Hearings on the Enron Collapse*, *supra* note 6, at 104 (statement of Mike Rath, Benefits Manager, Enron Corporation). Rath explains that in January of 2001, Enron began soliciting bids from third-party service providers to replace Northern Trust as the plan administrator for all of Enron's qualified retirement plans. In May of 2001, Hewitt was selected as Northern Trust's replacement. *Id.*

[21] *Id.* at 105-07 (statement of Scott Peterson, Global Practice Leader for Defined Contribution Services, Hewitt Associates) (indicating that the blackout began at the close of business on October 26, 2001 and ended on November 13, 2001).

[22] *See* Ellen E. Schultz, *'Lockdowns' of 401(k) Plans Draw Scrutiny*, WALL ST. J., Jan. 16, 2002, at C1, 2002 WL-WSJ 3383076 ("On Oct. 26, the last day employees could trade their accounts, the stock closed at $15.40 a share; by the end of the lockdown on Nov. 13, it had fallen to $9.98.").

[23] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 1. Enron filed for bankruptcy on December 2, 2001. *Id.*

[24] Jim Krane, *WorldCom to Hand Out $36 Million in Severance*, SEATTLE TIMES, Oct. 2, 2002, at E6, 2002 WL 3916038 ("After declaring that its accounting practices had hidden $3.8 billion in expenses, WorldCom declared the largest Chapter 11 bankruptcy in U.S. history. Since that July filing, the company has revised the amount of accounting improprieties up to $7.1 billion. Recent reports said the final total may reach $9 billion.").

401(k) plan losses attributable to company stock holdings.[25] And, contrary to pension reform opponents that characterize the Enron and WorldCom debacles as isolated examples of unscrupulous employers that inappropriately promote company stock ownership,[26] significant losses have occurred in the absence of such levels of abuse. Employees of Rite Aid, Lucent Technologies, Nortel Networks, Qwest Communications, the Williams Companies, Providian Financial Corporation, IKON Office Solutions, and Global Crossing, to name only a few, have suffered similar fates.[27]

With the Enron debacle as its primary impetus, the Bush Administration and Congress heard renewed public outcries for pension reform.[28] The Bush Administration and Congress initially focused their collective efforts on legislative reform proposals amending the Employee Retirement Income Security Act ("ERISA"),[29] the federal regulatory scheme governing employee benefit plans, including 401(k) retirement plans.

While disagreement exists about the appropriate means to resolve excessive investment in company stock, there is a general consensus about the current regulatory scheme's inability to provide the answer. Over the more than twenty-five years since its enactment, subsequent federal legislative and regulatory efforts have transformed ERISA into a relic of its

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[25] Yuki Noguchi, *Workers' 401(k)s Lost $1.1 Billion*, WASH. POST, July 10, 2002, at E01, 2002 WL 3450622.

[26] *See, e.g., Main Street Opposes Levin Senate Stock Options Bill*, Republican Main Street Partnership, *at* http://www.republicanmainstreet.org/news.asp?record_no=2104 (Feb. 25, 2002) (also on file with author); *401(k) Plans After Enron*, VeraVest Investments, *at* http://veravest.com/ww/ww169/previous/03_02.html (last visited Nov. 4, 2003) (also on file with author).

[27] Patrick J. Purcell, *Employer Stock in Retirement Plans: Investment Risk and Retirement Security*, CRS Rpt. for Cong., 107th Cong. at 1 (July 2002) [hereinafter Purcell, *Employer Stock in Retirement Plans*], http://www.benefitslink.com/articles/crs_empstock2002.pdf.

[28] Excessive investment in qualifying employer securities and real property was initially addressed by the Department of Labor and Congress in 1997. *See* U.S. DEP'T OF LABOR, ADVISORY COUNCIL ON EMPLOYEE WELFARE AND PENSION BENEFITS PLANS, REPORT OF THE WORKING GROUP ON EMPLOYER ASSETS IN ERISA EMPLOYER-SPONSORED PLANS (1997), http://www.dol.gov/ebsa/publications/acemar.htm [hereinafter DOL, EMPLOYER ASSETS IN ERISA EMPLOYER-SPONSORED PLANS]; U.S. GEN. ACCOUNTING OFF., 401(K) PENSION PLANS: EXTENT OF PLANS' INVESTMENTS IN EMPLOYER SECURITIES AND REAL PROPERTY, GAO/HEHS-98-28 (1997) [hereinafter GAO REPORT, 401(K) PENSION PLANS].

[29] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (providing pension reform).

time. The pre-ERISA retirement plan universe consisted almost exclusively of "traditional retirement plans," which are defined herein to include employer-funded defined benefit plans and supplemental individual account plans whose assets are invested by plan fiduciaries that remain personally liable for imprudent investment decisions. Congress designed ERISA within this context to foster two federal policy goals: the primary goal of retirement security[30] and the secondary goal of employee ownership.[31] To promote the retirement security goal that was predominantly advanced through employers' defined benefit plans, ERISA contains a series of fiduciary standards and prohibited transaction rules that require plan fiduciaries to diversify plan assets among prudent investment alternatives and restrict investment in company stock.[32] To promote the employee ownership goal that was historically relegated to supplemental individual account plans, ERISA creates a series of modifications to these standards and rules to accommodate a greater degree of individual account plan investment in company stock.[33]

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[30] H.R. REP. NO. 93-807 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4670, 4676 ("One of the most important matters of public policy facing the nation today is how to assure that individuals who have spent their careers in useful and socially productive work will have adequate incomes to meet their needs when they retire.").

[31] *Written Statement Submitted by Interested Organizations and Individuals on H.R. 10470: Retirement Income Security for Employees Act 3*, 93d Cong. 468 (Oct. 1, 1973) ("In a stock bonus plan, the emphasis is on employee incentive and, accordingly, the Internal Revenue Code has long permitted employers to use a stock bonus plan to create employee ownership in employer securities"); *Welfare and Pension Plan Legislature: Hearings Before the General Subcommittee on Labor of the Comm. on Educ. and Labor on H.R. 2 and H.R. 462*, 93d Cong. 665 (Feb. 20, 1973) (statement of Raymond H. Giesecke, Chairman of the Board of Directors, McGraw-Edison Co.) ("The Company's policy on investments also has been influenced by what the Company believes to be a long established Congressional policy of encouraging employee ownership of stock in the companies for which they work. This long standing Congressional policy is set forth in Sections 402(a), 422 and 423 of the Internal Revenue Code.").

[32] *See* ERISA § 404(a)(1)(A)-(D), 29 U.S.C. § 1104(a)(1)(A)-(D) (2000); ERISA § 406, 29 U.S.C. § 1106 (2000).

[33] *See* ERISA § 404(a)(2) (creating an exception to the fiduciary duty of diversification for eligible individual account plans); *id.* §§ 406 (a)(2), 407(b)(1) (creating an unlimited statutory exemption to the prohibition on plan asset investment in "qualifying employer securities").

In this new era where 401(k) plans have replaced traditional retirement plans as the dominant retirement plan,[34] ERISA's carefully crafted and limited support for employee ownership is removed from its historical justification and inappropriately interjected into an employer's 401(k) plan. In this new context, ERISA's protectionist scheme fails to protect 401(k) plan participants' retirement security. As employers abandon their role as the primary plan contributor that makes all of the plan's investment decisions,[35] ERISA's fiduciary standards do nothing to limit 401(k) plan participants' ability to direct investment in any employer-selected investment alternative, including company stock.[36] ERISA's fiduciary standards also do little to limit plan fiduciaries' ability to offer company stock as a 401(k) plan investment alternative or direct employer contributions in the form of company stock.[37]

Lacking consensus about the appropriate means to reform ERISA's regime, pension reform slipped into virtual obscurity with the 2002 election of a Republican majority to both houses of Congress. The only pension

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[34] *See Retirement Security and Defined Benefit Pension Plans, Hearing Before the H.R. Subcomm. on Oversight for the Comm. on Ways and Means*, 107th Cong. 4 (2002) (statement of Dallas L. Salisbury, President and CEO of EBRI) ("[D]efined benefit plans are on the decline and [401(k) plans] are becoming the primary 'pension' plans in the nation.") [hereinafter *Hearing on Retirement Security*]; Alicia H. Munnell et al., *How Important are Private Pensions?*, ISSUES IN BRIEF (Ctr. for Retirement Research, Chestnut Hill, Mass.), Feb. 2002, at 6, http://www.bc.edu/centers/crr/issues/ib_8.pdf (discussing the shift from defined benefit plans to individual account plans with a 401(k) feature); Mitchell & Utkus, *supra* note 4, at 2 (noting the continuing decline of defined benefit plans in terms of number and coverage).

[35] U.S. DEP'T OF LABOR, PENSION AND WELFARE BENEFITS ADMIN., PRIVATE PENSION PLAN BULLETIN NO. 11: ABSTRACT OF 1998 FORM 5500 ANN. REP. (Winter 2001-2002) Highlights from the 1998 Form 5500 Annual Reports (Winter 2001-2002), http://www.dol.gov/ebsa/pdf/1998pensionplanbulletin.pdf [hereinafter PRIVATE PENSION PLAN BULLETIN] ("Of total employer and employee contributions made to 401(k) type plans, employees made 67%. For workers participating only in a 401(k), employees contributed 63% of total contributions, and for workers participating in both a 401(k) plan and another plan sponsored by their employer[,] employees contributed 71%."); *id.* ("Seventy-nine percent of 401(k) type plans, covering 83% of the active participants, and holding 81% of the assets, provided for participant direction of investments of either all assets or assets based on employee contributions.").

[36] *See infra* text accompanying notes 94-100 (explaining that fiduciary duties do not apply to ERISA § 404(c) plan participants).

[37] *See* discussion *infra* Part I.B.2 (describing retained fiduciary duties).

reform measure enacted into law was an ancillary measure addressing insider trading during blackouts and blackout notification requirements, which was included in the Sarbanes-Oxley Act,[38] an act designed primarily to address the accounting and corporate responsibility issues raised by the Enron debacle. In spite of a deluge of more than twenty pension reform bills that were introduced in Congress,[39] none was enacted into law.

The 108th Congress is showing signs of gearing up for yet another round of pension reform debates with the House of Representatives' reintroduction of the House-passed Pension Security Act of 2002,[40] which reflects the Bush Administration's pension reform proposals,[41] and the Senate Democratic Caucus' introduction of the Pension Protection and Expansion Act of 2003 (the "Senate Finance Bill").[42] With Congress's current Republican majority, the reintroduced Pension Security Act of 2003 (the "House Bill") garners the broadest support and is the likely candidate for pension reform.

The House Bill, however, rejects overall limitations on 401(k) plan investment in company stock. Overall limitations could limit account asset investment in company stock to a certain percentage of total account assets, for example, 20% of a participant's account assets can be invested in company stock. Alternatively, overall limitations could restrict the types of contributions that can be made in the form of company stock, for example, employer contributions or employee elective deferral contributions can be

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[38] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 306, 116 Stat. 745, 779-80 (2002) (passed by both houses of Congress on July 30, 2002).

[39] H.R. 3463, 107th Cong. (2002); H.R. 3509; H.R. 3622; H.R. 3623; H.R. 3640; H.R. 3642; H.R. 3657; H.R. 3669; H.R. 3677; H.R. 3692; H.R. 3762; H.R. 3840; H.R. 3918; H.R. 2269; S. 1838, 107th Cong. (2002); S. 1919; S. 1921; S. 1969; S. 1971; S. 1992; S. 2032; S. 2087; S. 1677.

[40] H.R. 3762, 107th Cong. (2002) (passed the full House on April 11, 2002 by a vote of 255 to 163); Press Release, House Comm. on Ed. and the Workforce, Workforce Committee Approves Bipartisan Pension Security Act (Mar. 6, 2003), http://edworkforce.house.gov/press/press108/03mar/pension030603.htm (Mar. 6, 2003) (Pension Security Act of 2002 reintroduced as Pension Security Act of 2003, H.R. 1000, 108th Cong. (2003) and approved by the House Education & the Workforce Committee on March 6, 2003).

[41] *See* Press Release, Rep. John Boehner, Boehner, Johnson Announces Plans to Reintroduce Pension Security Act (Jan. 7, 2003), http://johnboehner.house.gov/news.asp?FormMode=Detail&ID=601 [hereinafter Press Release, Plans to Reintroduce Pension Security Act].

[42] S. 9, 108th Cong. (2003). The bill was referred to the Committee on Finance on Jan. 7, 2003. Bill status available at http://www.thomas.loc.gov.

made in the form of company stock, but not both. Instead, the House Bill relies on ancillary pension reform measures that are being touted as the *sine qua non* of pension plan reform, including a proposal giving participants the ability to diversify company stock holdings,[43] a proposal encouraging voluntary employer-facilitated investment advice,[44] and notification proposals aimed at alerting participants of the importance of adequate plan asset diversification.[45]

Part I of this Article provides an overview of the changing landscape of voluntary, employer-sponsored retirement plans.[46] This part details ERISA's protectionist scheme as it relates to fiduciary standards and prohibited transaction rules and how Congress designed this scheme within the context of traditional retirement plans to support the dual federal policy goals of retirement security and employee ownership. Part I also deals with the fundamental shift away from traditional retirement plans and toward 401(k) plan dominance and how this fundamental shift has influenced retirement plans by placing the employee ownership goal in employers' primary retirement plans, eviscerating many of the fiduciary protections once available to traditional individual account plan participants, and resulting in a lack of adequate plan asset diversification.

Part II provides a critical analysis of the Republican-backed House Bill's failure to implement overall limitations on 401(k) plan investment in company stock by analyzing the arguments against applying such limitations.[47] This part also provides a critical analysis of select ancillary pension reform measures included in the House Bill and the blackout notification requirements enacted under the Sarbanes-Oxley Act.[48]

Part III concludes that the House Bill is fatally flawed.[49] The House Bill fails to deliver ERISA's promise of a secure retirement because it rejects overall limitations on 401(k) plan investment in company stock and relies on ancillary measures that cannot effectively accomplish sufficient plan asset diversification. Specifically, meaningful pension reform must contain overall limitations on 401(k) plan investment in company stock, such as the

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[43] H.R. 1000, 108th Cong. § 104.

[44] *Id.* § 105.

[45] *Id.* § 101(b) (mandating additional dissemination of quarterly benefit statements and investment education notices).

[46] *See infra* notes 51-209 and accompanying text.

[47] *See infra* notes 210-78 and accompanying text.

[48] *See infra* notes 279-338 and accompanying text; *see also* ERISA § 101(i), 29 U.S.C. § 1021(i) (2002), *amended by* Pub. L. No. 107-204, § 306(b)(1).

[49] *See infra* notes 339-50 and accompanying text.

Senate Finance Bill "choice" proposal,[50] which places a de facto limitation on 401(k) plan company stock holdings by restricting the types of contributions that can be made in the form of company stock. This limitation is necessary to combat inherent employer influences over participants' investment decisions. Meaningful pension reform must also mandate the appointment of an independent fiduciary when employers offer company stock as a 401(k) plan investment alternative. An independent fiduciary is necessary to ensure that company stock remains a prudent investment selection and that employers are not exerting improper influences over participants' investment decisions. Finally, meaningful pension reform must include the mandatory provision of independent, individually-tailored investment advice as a cost of transferring investment decisions to participants. This is necessary to ensure that participants are provided with the tools to make educated investment decisions among employer-selected investment alternatives.

I. THE CHANGING LANDSCAPE OF RETIREMENT PLANS AND THE EVISCERATION OF ERISA'S PROTECTIONIST SCHEME THROUGH A FUNDAMENTAL SHIFT TO 401(K) PLAN DOMINANCE

A. ERISA'S Federal Legislative Regime Supporting the Dual Federal Policy Goals of Retirement Security & Employee Ownership

Recognizing "that the continued well-being and security of millions of employees and their dependents"[51] were being threatened by employer abuses of the day, Congress enacted ERISA in 1974 to provide a comprehensive federal regulatory scheme for voluntary employer-sponsored retirement plans.[52] Consistent with the federal government's fifty-year history of supporting these voluntary arrangements,[53] Congress designed ERISA's statutory scheme to reflect two federal policy goals. The first and primary goal of ERISA is to promote retirement security.[54] Although the

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[50] S. 9, 108th Cong. § 104 (incorporating the Kennedy "choice proposal" introduced in S. 1992, 107th Cong. § 102).

[51] ERISA § 2(a) (2000).

[52] *Id.* § 2(b).

[53] For a review of major legislative acts and a brief history of retirement plans, see EBRI, *Facts from EBRI, History of Pension Plans* (1998), http://www.ebri.org/facts/0398afact.htm.

[54] ERISA of 1974, Pub. L. No. 93-406, § 2, 88 Stat. 829, preamble (1974) ("It is hereby further declared to be the policy of this act to protect . . . the interests of participants in private pension plans and their beneficiaries by improving the

retirement security goal is present in both types of retirement plans, historically, the goal is closely linked to defined benefit plans which dominated the pre-ERISA retirement plan landscape.[55] These plans provide a fixed benefit and represent a quantifiable promise by employers to pay participants a set sum annually during post-retirement years.[56] The employer secures the promised benefit through contributions made to a trust fund. Furthermore, to the extent that trust fund assets fail to provide the promised benefit, the employer remains liable for any funding deficit.[57]

The second federal policy goal is to promote employee ownership through some level of retirement plan investment in company stock.[58] Historically, this goal is closely linked to the second type of retirement plan, the individual account plan. Individual account plans provide benefits based on contributions made to trust fund accounts established for each plan participant.[59] In contrast to defined benefit plans, individual account plans do not guarantee a set amount. The only promised benefit is the balance of the participant's individual account at the time the participant is eligible to receive the account balance and thereafter requests a distribution, with such account balance being determined by past contributions as adjusted for earnings and losses on account investments.[60]

Prior to the enactment of ERISA, the individual account plan universe consisted almost entirely of employer-funded profit sharing plans and employee stock ownership plans ("ESOP"), the latter designed to invest primarily in qualifying employer securities.[61] These pre-ERISA individual

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equitable character and the soundness of such plans by requiring them to vest the accrued benefits of employees with significant periods of service, to meet minimum standards of funding, and by requiring plan termination insurance.").

[55] *See* Leon E. Irish, *Twenty Years of Employee Benefits*, 1 J. PENSION PLAN & COMPLIANCE 10-12 (1992) (noting that rising numbers of private pensions established before 1970 followed growth of labor movement, typically characterized by large defined benefit pension plans) (on file with author).

[56] ERISA § 3(35) (defining "defined benefit plan").

[57] *Id.* §§ 302(b)(3), (c)(11), (d)(4).

[58] *See supra* note 31 (describing employee ownership goal in supplemental individual account plans).

[59] ERISA § 3(34) (otherwise referred to as "defined contribution plans"); *see also* I.R.C. §§ 414(i) & (j) (2000).

[60] ERISA § 3(34).

[61] *Id.* § 407(c)(6) (defining an "employee stock ownership plan" as "an individual account plan (A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified, under § 401 of the Internal Revenue Code of 1954, and which is designed to invest primarily in qualifying employer securities, and (B) which meets such other requirements as the

account plans were supplemental plans not widely utilized as an employer's primary retirement plan.[62] Historically, these plans were funded by employer contributions made in the form of company stock[63] and were viewed by supporters of the employee ownership goal as an ideal vehicle for promoting that federal policy.[64]

In the context of these dual federal policy goals, ERISA's regulatory scheme contains fiduciary standards akin to those found under the common law of trusts.[65] Designed to address previously identified employer abuses, including imprudent investment practices and excessive investments in company stock,[66] the fiduciary standards help ensure that plan fiduciaries, who are generally defined as persons who have any discretionary authority, control, or responsibility with respect to the management and administration of an employee benefit plan,[67] "discharge [their] duties . . . solely in the

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Secretary of the Treasury may prescribe by regulation.").

[62] *Hearing on Retirement Security*, *supra* note 34, at 1 (statement of Dallas L. Salisbury, President and CEO of EBRI) (At the time of ERISA's enactment, "[e]ssentially all of the nation's largest employers had a defined benefit plan and a thrift-saving or profit-sharing plan. . . .").

[63] *See* Mitchell & Utkus, *supra* note 4, at 3-4 (explaining that defined contribution "plans consisted mainly of profit-sharing plans to which employers made variable plan contributions based on company earning, and [ESOPs] which by design encouraged employers to make employer stock contributions in an effort to foster employee ownership. DC plans were thus not widely used as a retirement income vehicles [sic] and at many large firms, they were supplemental to DB programs").

[64] *Hearings on the Enron Collapse*, *supra* note 6, at 48 (statement of Elaine L. Chao, Secretary, United States Department of Labor) ("Congress viewed individual account plans as having a different purpose from than [sic] defined benefit plans. Also, Congress noted that these plans had traditionally invested in company securities.").

[65] *See* Cent. States, S.E. & S.W. Areas Pension Fund v. Cent. Transp. Inc., 472 U.S. 559, 570 n.10 (1985) (citing S. REP. NO. 93-127, at 29 (1973), 1974 U.S.C.C.A.N. (88 Stat. 832) 4639, 4865) ("The fiduciary responsibility section, in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts.").

[66] *See* 120 CONG. REC. S15,738-15,741 (Aug. 22, 1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 5186-87 (statement of Sen. Williams). For a discussion of the legislative history of ERISA, see JOHN H. LANGBEIN ET AL., PENSION & EMPLOYEE BENEFIT LAW 62-96 (3d ed. 2000).

[67] ERISA § 3(21), 29 U.S.C. § 1001(a)(21) (2003). ERISA defines fiduciary to include any person who either:

> (i) . . . exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control

interest of [plan] participants."[68] Plan fiduciaries that breach these duties are personally liable for any gains derived by the fiduciary or for any losses incurred by the plan.[69] Furthermore, plan fiduciaries may even be liable for the misconduct of co-fiduciaries where the former's actions either contributed to the breach of duties or tacitly enabled the latter to breach their duties.[70]

Of ERISA's four general fiduciary standards,[71] three directly impact retirement plan investment decisions: the duties of loyalty, prudence, and diversification.[72] Under the duty of loyalty standard, plan fiduciaries must discharge their duties for the exclusive purpose of providing benefits to participants and defraying reasonable administrative costs of the plan.[73] Courts interpret this duty to mean that plan fiduciaries must act "with an

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> respecting management or disposition of its assets, (ii) . . . renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or (iii) . . . has any discretionary authority or discretionary responsibility in the administration of such plan.

Id.

[68] *Id.* § 404(a)(1), 29 U.S.C. § 1104(a)(1) (2003).

[69] *See id.* § 409.

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries . . . shall be 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. . . .

Id.

[70] *Id.* § 405(a). Under the co-fiduciary provisions, one fiduciary is liable for a breach by a second fiduciary under the following circumstances:

> (1) if the first fiduciary "participates knowingly in, or knowingly undertakes to conceal, an act or omission" of the second fiduciary, knowing that the second fiduciary is violating his fiduciary duties; (2) if the first fiduciary's failure to discharge his own fiduciary duties enables the second fiduciary to commit a breach; or (3) if the first fiduciary knows of a breach by the second fiduciary and fails to make reasonable efforts to remedy the breach.

Id.

[71] *Id.* § 404(a)(1)(A)-(D).

[72] *See id.* § 404(a)(1)(A)-(C).

[73] *Id.* § 404(a)(1)(A).

eye single to the interests of the participants"[74] and cannot place others' interests above participants' interests.[75]

Under the duty of prudence standard, plan fiduciaries must act with the "care, skill, prudence and diligence" that a prudent person familiar with such matters would use in similar circumstances.[76] This duty of prudence dictates that plan fiduciaries responsible for investment decisions have sufficient expertise and familiarity with investment matters to make educated investment decisions.[77]

Under the duty of diversification standard, a cornerstone principle of prudent investment practices,[78] plan fiduciaries must generally diversify plan investments in order to minimize the risks associated with specific investments.[79] While imposing no quantifiable limit on the degree of investment concentration, ERISA conference committee reports indicate that plan investment decisions, including diversification decisions, must be made based on all of the facts and circumstances then available to plan fiduciaries, including an evaluation of the firm-specific and industry-specific risks of each investment.[80]

ERISA also established prohibited transaction rules[81] to counter perceived abuses of the time.[82] Designed to eliminate self-dealing transactions that benefit plan fiduciaries and other interested parties at the participants'

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[74] Leigh v. Engle, 727 F.2d 113, 125 (7th Cir. 1984) (quoting Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982)); *see also* Sandoval v. Simmons, 622 F. Supp. 1174, 1212 (C.D. Ill. 1985).

[75] *See, e.g.*, Reich v. Compton, 57 F.3d 270, 278 (3d Cir. 1995); Trenton v. Scott Paper Co., 832 F.2d 806, 809 (3d Cir. 1987); Dasler v. E.F. Hutton & Co., 694 F. Supp 624 (D. Minn. 1988) (holding that a fiduciary under ERISA had a duty of complete and undivided loyalty to participants and beneficiaries).

[76] ERISA § 404(a)(1)(B).

[77] *See, e.g.*, Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983); *In re* Unisys Sav. Plan Litig., 173 F.3d 145, 150-53 (3d Cir. 1999).

[78] Bodie & Crane, *supra* note 2, at 5.

[79] ERISA § 404(a)(1)(C) ("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").

[80] H.R. Conf. Rpt. 93-1280 (Aug. 12, 1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5084-5085. For an analysis of the diversification requirement, see, for example, Reich v. King, 861 F. Supp. 379, 383 (D. Md. 1994); *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 438 (3d Cir. 1996); Brock v. Citizens Bank of Clovis, 1985 WL 71535 *3 (D.N.M. Dec. 20, 1985).

[81] ERISA § 406.

[82] 120 CONG. REC. § 15737 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4650-51.

expense,[83] the prohibited transaction rules restrict a plan fiduciary's ability to direct investment in employer securities, including company stock,[84] without qualifying for a statutory exemption or seeking an administrative exemption from the Department of Labor ("DOL").[85] Plan fiduciaries, and certain non-fiduciary "parties in interest,"[86] that enter into unauthorized prohibited transactions are personally liable to the plan for any resulting losses.[87]

While these standards and rules apply to both types of retirement plans, ERISA contains three primary modifications that impact plan asset investment decisions in the context of company stock holdings. First, to accommodate Congress' support of the employee ownership goal in supplemental individual account plans, ERISA creates an exception to the fiduciary duty of diversification for "eligible individual account plans," such as profit sharing plans and ESOPs.[88] Theoretically, this exception allows plan fiduciaries to invest up to 100% of eligible individual account plan assets in "qualifying employer securities," including company stock.[89]

In its historical context, where plan fiduciaries retain authority for investment decisions, the eligible individual account plan modification to the fiduciary duty of diversification came with a price. Under the remaining fiduciary duties of loyalty and prudence, plan fiduciaries are required to make prudent investment decisions consistent with professional guidelines in the field of finance and investment.[90] These guidelines establish

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[83] *Id.*

[84] ERISA § 406(a)(1)(E); *see also id.* § 407(d)(1).

[85] *Id.* §§ 406(a)(1)(E), 408.

[86] ERISA § 3(14), 29 U.S.C. § 1002(14) (2003) (defining "party in interest" to include plan fiduciaries and persons providing services to the plan).

[87] ERISA § 409(a), 29 U.S.C. § 1109(a) (2003); ERISA § 502(i); *see also* Harris Trust & Savs. Bank v. Salomon Smith Barney Inc., 530 U.S. 238, 239 (2000) (recognizing a cause of action against nonfiduciaries who participate in a prohibited transaction, but limiting relief to "appropriate equitable relief" under ERISA Section 502(a)(3)).

[88] *See* ERISA §§ 404(a)(2), 407(d)(3)(A)-(C) (defining "eligible individual account plan" to include a profit sharing, stock bonus or savings plan, employee stock ownership plan, and certain pre-ERISA money purchase plans that explicitly provide for the acquisition and holding of qualifying employer securities and are not part of a defined benefit plan floor-offset arrangement).

[89] *Id.* § 404(a)(2).

[90] *Id.* (exempting the prudence requirement "only to the extent that it requires diversification" and leaving the fiduciary duty of loyalty in tact).

the status quo as a well-diversified investment portfolio[91] and indicate that investing more than 10 to 20% of plan assets in a single investment may be imprudent.[92] Thus, these professional guidelines preclude eligible individual account plan fiduciaries from imprudently attaining an excessive concentration in any one investment, including employer company stock.[93]

Second, ERISA permits plan fiduciaries to transfer individual account plan investment decisions to participants ("ERISA Section 404(c) plans").[94] Although ERISA's legislative history does not explain the policy rationale supporting this modification, it appears the modification was created, in part, to accommodate pre-ERISA thrift savings plans, the precursor to today's 401(k) plan. Thrift savings plans provide for employee contributions made on an after-tax basis and are usually part of an employer's profit sharing plan.[95] Arguably, Congress believed participants should be given the ability to direct the investment of employee after-tax contributions, which are not tax-subsidized contributions and belong solely to participants. ERISA Section 404(c), however, is broader in application and allows plan fiduciaries to transfer all individual account plan investment decisions to participants.[96]

Under this second modification, ERISA Section 404(c) plan fiduciaries are not liable for any loss or breach of fiduciary duty that is the result of participants' independent investment decisions.[97] Absent this protection, plan fiduciaries might be held liable for participants' imprudent investment decisions, even educated and informed ones.[98] Further, ERISA Section 404(c) provides that participants who direct the investment of their account assets will not be considered plan fiduciaries.[99] Thus, ERISA Section

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[91] *See* Lisa Meulbroek, *Company Stock in Pension Plans: How Costly Is It?* 9 (Harvard Bus. Sch., Working Paper No. 02-058, 2002), http://www.hbs.edu/research/facpubs/workingpapers/papers2/0102/02-058.pdf; Bodie & Crane, *supra* note 2.

[92] Purcell, *Employer Stock in Retirement Plans*, *supra* note 27, at 10 (noting that many advisors recommend a 10% to 20% limit as the maximum exposure to a single firm's securities).

[93] *See supra* note 90.

[94] ERISA § 404(c).

[95] *See* Rev. Rul. 74-385, 1974-2 C.B. 130 (1974).

[96] ERISA § 404(c).

[97] *Id.* § 404(c)(1)(B).

[98] *Id.*

[99] *Id.* § 404(c)(1)(A).

404(c) plan participants are not subject to ERISA's fiduciary duties, including the duty of prudence that dictates safe investment practices.[100]

Third, to accommodate Congress' limited support of the goal of employee ownership in traditional retirement plans, ERISA creates an exception under the prohibited transaction rules for plan asset investment in "qualifying employer securities."[101] ERISA severely limits this exception for defined benefit plans. Based upon their close relationship to ERISA's retirement security goal, defined benefit plans are restricted from investing more than 10% of plan assets in qualifying employer securities,[102] and then only if holding these assets otherwise meets ERISA's fiduciary standards of loyalty, prudence and diversification.[103] Consistent with the then supplemental status of individual account plans, and the employee owner-

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[100] *Id.*

[101] *Id.* §§ 407(a)(2), 407(b)(1). Section 407(d)(5) defines a "qualifying employer security" to mean only: (1) publicly traded common stock of the employer or a member of the same controlled group of corporations; (2) if there is no publicly traded common stock, common stock of the employer (or member of the same controlled group of corporations) that has both voting power and dividend rights at least as great as any other class of common stock; or (3) noncallable preferred stock that is convertible into common stock described in (1) or (2) and that meets certain requirements and that is held only by an ESOP. *But see id.* § 407(f)(1). After December 17, 1987, employer stock is considered a qualifying employer security only if the plan is an eligible individual account plan or, in the case of defined benefit plans, the security meets certain definitional requirements established under ERISA section 407(f)(1), which generally provides that no more than 25% of the outstanding stock of the same class is owned by the plan and at least 50% of the outstanding stock of the same class is owned by persons independent of the employer. *Id.* § 407(f)(2).

[102] *Id.* § 407(a)(2).

[103] H.R. CONF. REP. NO. 93-1280 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5037, 5085.

> If securities are qualifying employer securities they generally can be acquired or held notwithstanding the prohibited transaction rules, if acquisition is for adequate consideration and no commission is charged and if acquisition is allowed by the employer securities rules. However . . . acquisition and holding of these assets must also meet the rules of prudence, diversification, etc. Therefore, if the diversification and prudence rules require that less than 10 percent of plan assets are to be held in employer securities and employer real property, the lower limit is to govern.

Id.

ship goal promoted by these plans,[104] eligible individual account plan investment in qualifying employer securities is not subject to any percentage limitation.[105] It is, however, theoretically limited by the fiduciary standards of loyalty and prudence.[106]

B. *The Proliferation of 401(k) Plans and the Evisceration of ERISA's Protectionist Scheme*

Beginning in the late 1970s, the retirement plan universe began a dramatic shift away from traditional retirement plans toward participant-directed individual account plans.[107] The primary impetus for this shift occurred in 1978, when Congress created the 401(k) plan.[108] These plans authorize employer sponsorship of an individual account plan providing participants with the opportunity to defer a part of their compensation on a pre-tax basis.[109] With their employee elective deferral contribution feature, 401(k) plans transformed individual account plans from their historical status as the receptacles of corporate profits to the receptacles of employee contributions.[110]

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[104] *See* Mitchell & Utkus, *supra* note 4, at 3 ("Many prominent employers viewed DC plans as vehicles for promoting employee stock ownership and so they objected to limitations on company stock holdings." (citation omitted)).

[105] ERISA § 407(b)(1). *But see id.* § 407(d)(3)(A) (Money purchase pension plans, which may qualify as "eligible individual account plans" if the former was established prior to the enactment of ERISA.).

[106] Canale v. Yegen, 782 F. Supp. 963, 967 (D.N.J. 1992) ("This provision does not mean that failure to diversify pension assets invested in employer securities can *never* constitute a breach of ERISA fiduciary duties."); McKinnon v. Cairns, 698 F. Supp. 852, 862 (W.D. Okla. 1988).

[107] PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 64, tbl.E1 (stating that in 1979, employers sponsored 139,489 defined benefit plans and 331,432 individual account plans, compared to 1998 with employers sponsoring 56,405 defined benefit plans and 673,626 individual account plans).

[108] Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763 (1978) (codified as amended at I.R.C. § 401(k) (2003)); *see also* PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 2 ("Paralleling the decline in [defined benefits] plan coverage has been a decline in coverage under DC [defined benefits] plans without a 401(k) plan feature. Most of this decline resulted from the adoption of a 401(k) feature by ongoing DC plans.").

[109] *See supra* note 108.

[110] PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 3 ("Of total employee contributions made to 401(k) type plans, employees made 67%. For workers participating only in a 401(k), employees contributed 63% of total contributions,

The secondary impetus for this fundamental shift occurred in 1992, with the DOL's promulgation of ERISA Section 404(c) regulations.[111] This regulatory guidance, issued eighteen years after the creation of ERISA Section 404(c) plans, outlines how employers can effectively transfer control over investment decisions, and the corresponding risk of those decisions, to participants.[112]

Relieved of significant funding liabilities and regulatory uncertainties, employers embraced 401(k) plans designed as ERISA Section 404(c) plans.[113] Since the creation of 401(k) plans, they have become the dominant retirement plan with 41% of all plans designed as 401(k) plans and 51% of all active participants covered under these plans.[114] These figures translate into over forty-two million American workers participating in over 300,000 employer-sponsored 401(k) plans.[115] Further, in a little more than ten years since the DOL promulgated ERISA Section 404(c) regulations, the vast majority of 401(k) plans are now designed as ERISA Section 404(c) plans ("participant-directed 401(k) plans").[116]

The following sub-part addresses how this fundamental shift affects 401(k) plan participants employed by large publicly traded companies, which are more likely to offer a company stock investment alternative. Specifically, it looks at how the interplay between 401(k) plans and traditional retirement plans potentially jeopardizes participants' retirement security, how the proliferation of 401(k) plans dilutes ERISA's fiduciary protectionist scheme, and how employers are ineffectively transferring

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and for workers participating in both a 401(k) plan and another plan sponsored by their employer[,] employees contributed 71%.").

[111] ERISA Rules and Regulations for Fiduciary Responsibility, 29 C.F.R. § 2550.404c-1 (2003).

[112] *Id.* § 2550.404c-1(d)(2).

[113] Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. MICH. J.L. REFORM 469, 477-78 (2001) [hereinafter Medill, *Stock Market Volatility and 401(k) Plans*].

[114] PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 2.

[115] *See id.* at 47, tbl.D3 (300,593 401(k) type plans); *Hearing on Protecting the Pensions of Working Americans: Lessons From the Enron Debacle: Before the Sen. Comm. on Health, Educ., Lab. and Pensions*, 107th Cong. 3 (2002) (statement of Dallas L. Salisbury, President and CEO, Employee Benefit Research).

[116] *See* PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 3 (estimating that approximately "79 percent of all 401(k) type plans, covering 83 [percent] of the active participants, and holding 81 [percent] of the assets, provided for participant direction of investments of either all assets or assets based on employee contributions").

investment decisions to plan participants who are incapable of making prudent investment selections.

1. *The Interplay Between 401(k) Plans and Traditional Retirement Plans*

There are several deleterious effects that flow from 401(k) plan dominance, the most important of which is the current interaction between 401(k) plans and traditional retirement plans. With respect to traditional defined benefit plan sponsorship, DOL statistics indicate that, between 1983 and 1998, sponsorship of large defined benefit plans decreased by 41.7%, which resulted in approximately six million fewer active large defined benefit plan participants.[117] Companies such as Procter & Gamble, Home Depot, McDonald's, and Dell Computer do not sponsor defined benefit plans, but instead, sponsor 401(k) plans for their employees.[118]

Even with respect to those large, publicly traded companies that are the stalwarts of defined benefit plan sponsorship,[119] employer sponsorship of a 401(k) plan negatively impacts an employer's defined benefit plan sponsorship. In reviewing data collected from 827 companies over a fourteen-year period, Dr. Teresa Ghilarducci found that employer sponsorship of a 401(k) plan reduced an employer's defined benefit plan

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[117] *See id.* at 66, tbl.E3 (showing that between 1983 and 1998, the number of large defined benefit plans fell from 25,979 to 15,141, or 41.7%); *id.* at 74, tbl.E10 (showing that between 1983 and 1998, number of active participants in large defined benefit plans fell from approximately twenty-eight million to twenty-two million).

[118] *See* Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 4.

[119] *See Hearings on Enron and Beyond Enhancing Worker Retirement Security: Hearing Before Comm. on Educ. and the Workforce*, 107th Cong. 107-44 (2002), 2002 WL 227987 [hereinafter *Hearings on Enron and Beyond Enhancing Worker Retirement Security*] (testimony of Dr. Douglas Kruse, Professor, School of Management & Labor Relations, Rutgers University) ("About 70-75% of participants in plans that are heavily invested in employer stock are in companies that also maintain diversified pension plans, indicating that such plans tend to supplement rather than substitute for diversified plans."); *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 8 (finding that employers who sponsor a defined benefit plan are more likely to provide a company stock investment alternative under their 401(k) plan and make employer contributions in the form of company stock, and thereby have a heavier concentration of company stock in their 401(k) plan).

costs "by almost one third."[120] This translates into a reduction of benefits provided under the defined benefit plan. Further, employer sponsorship of a 401(k) plan increases the likelihood that an employer will freeze the level of benefits offered under a defined benefit plan or terminate an existing defined benefit plan. A 1996 study commissioned by the DOL found that, for employers sponsoring large defined benefit plans, the addition of a 401(k) plan increased the probability of a defined benefit plan termination from 17% to 35%.[121]

With respect to traditional individual account plan sponsorship, 401(k) plans are now being integrated into employers' once supplemental stand-alone ESOPs. One of the driving forces behind this integration is a recent change enacted under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA").[122] Prior to 2002, C corporations were permitted a dividend deduction for cash dividends paid on ESOP company stock holdings if the dividends were generally distributed to ESOP participants.[123] To encourage asset accumulation and dividend reinvestment, few employ-

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[120] *Hearings on the Enron Collapse*, *supra* note 6, at 206 (testimony of Teresa Ghilarducci, Ph.D., Associate Professor, Department of Economics, University of Notre Dame).

[121] LESLIE E. PAPKE, U.S. DEP'T OF LABOR, PENSION AND WELFARE BENEFITS ADMINISTRATION, DOES 401(K) INTRODUCTION AFFECT DEFINED BENEFIT PLANS? 2 (SP-95-010) (July 11, 1996), http://www.DOL.gov/ebsa/programs/opr/P-RES/papke.htm ("[I]f a 401(k) plan is added by a sponsor, the [defined benefit plan] termination probability increases by about 18 percentage points to 35 percent.") (utilizing data from the 1985 and 1992 Form 5500 filings available from the Pension and Welfare Benefits Administration of the U.S. DOL, which examined a sample of approximately 16,500 defined benefit plans and 11,900 sponsors, author determined that employer sponsorship of individual account plans negatively impacted their continued sponsorship of previously established defined benefit plans, including: between 1985 and 1992, 20% of employers terminated their defined benefit plans and either retained or added an individual account plan; defined benefit plan offerings were reduced when employer adopts an individual account plan, with a sponsor terminating a defined benefit plan for approximately every three sponsors that offer at least one new 401(k) plan; the introduction of a non-401(k) individual account plan reduces defined benefit plan offerings). *Id.*

[122] Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).

[123] I.R.C. § 404(k)(2)(A) (2001) (defining "applicable dividend" where deductions are either: "(i) . . . paid in cash to the participants . . . ; (ii) . . . paid to the plan and distributed in cash to participants . . . [within] 90 days after the close of the plan year . . . ; or (iii) . . . used to make payments on a loan secured to buy ESOP company stock.").

ers took advantage of the dividend deduction and instead retained those dividends as plan assets. As a result of a change enacted under EGTRRA, C corporations can now take a dividend deduction when plan participants are given the option of reinvesting the dividends in company stock or taking cash distributions.[124] Thus, employers can now claim a dividend deduction on ESOP company stock holdings even when the dividend is not immediately distributable to participants.

This small change in the corporate tax law altered ESOP/401(k) plan design. To qualify for the dividend deduction, the dividends must be paid to an ESOP. This leaves company stock holding in non-ESOPs ineligible for the dividend deduction. To overcome this problem and maximize the potential dividend deduction, many large publicly traded companies are converting their 401(k) plans into hybrid plans with an ESOP component and a 401(k) component, referred to as KSOPs. Company stock can be held under the ESOP component of the plan, and all other investment selections can be held under the 401(k) component of the plan.[125] The dividend deduction is then available for all company stock held by the KSOP.

This hybrid structure translates into millions of dollars in tax savings for large publicly traded companies[126] and serves as a strong incentive for 401(k) plan conversion. Recent estimates indicate that about 4.8 million American workers (more than 10% of the 401(k) plan population) participate in large 401(k) plans designed as KSOPs.[127] In many cases, the 401(k) component of these plans, which once held both employee elective deferral contributions and employer contributions, is stripped down to a receptacle for employee elective deferral contributions directed to investment alternatives other than company stock. Further, the hybrid KSOP is transformed into a plan that primarily invests in company stock—an unintended result of EGTRRA.

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[124] *Id.* § 404(k)(2)(A)(iii) (2002) (as amended by Section 662(a) of Pub. L. No. 107-16); *see also* I.R.S. Notice 2002-2, 2002-2 I.R.B. 285 (Jan. 14, 2002).

[125] *See* Priv. Ltr. Rul. 200237026 (Sept. 13, 2002) (issuing a favorable ruling for a hybrid 401(k)/ESOP).

[126] *See* Mitchell & Utkus, *supra* note 4, at 37, tbl.3 (estimating the ESOP deduction under EGTRRA in the millions for numerous publicly traded companies) (citing Ellen E. Schultz & Theo Francis, *Companies' Hot Tax Break: 401(k)s*, WALL ST. J., Jan. 31, 2002, at C1).

[127] *Hearings on Enron and Beyond Enhancing Worker Retirement Security*, *supra* note 119 (testimony of Dr. Douglas Kruse, Professor, School of Management & Labor Relations, Rutgers University) (Referencing the Form 5500 database for large plans, Professor Kruse stated: "[T]here are about 3.2 million participants in large non-401(k) ESOPs, and 4.8 million participants in large 401(k) ESOPs.").

2. *Effect of 401(k) Plans on ERISA's Fiduciary Protectionist Scheme*

In adopting participant-directed 401(k) plans, first in the context of supplemental plans, and later in lieu of traditional retirement plans, employers shift much of the funding obligation[128] and the investment obligation[129] to participants. At the same time, the liability for investing employee elective deferral contributions is divorced from ERISA's fiduciary standards. The fiduciary duty protections afforded to traditional individual account plan participants apply only to the extent that plan fiduciaries continue to make investment decisions, "such as where plan fiduciaries make employer matching contributions in the form of company stock or where participants fail to direct account investments."[130] For all participant-directed investment decisions, to the extent that plan fiduciaries operate the plan in compliance with ERISA Section 404(c) requirements,[131] plan fiduciaries are relieved of liability for any loss or for any breach of fiduciary duty that is the direct and necessary result of participants' independent investment decisions.[132]

While ERISA Section 404(c)'s fiduciary liability relief does not completely insulate plan fiduciaries from all liability for participant-directed investments, the remaining protections are ill-defined and subject to a broad facts and circumstances analysis. The retained fiduciary duties of loyalty and prudence require plan fiduciaries to prudently select plan investment alternatives and to continuously monitor the performance of

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[128] *See* PRIVATE PENSION PLAN BULLETIN, *supra* note 35, at 2.

[129] *Id.*

[130] *See* 29 C.F.R. § 2550.404c-1(c)(1) (2003) (ERISA Section 404(c) applies "only with respect to a transaction where a participant or beneficiary has exercised independent control in fact with respect to the investment of assets in his individual account.").

[131] *See* Susan J. Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(k) Plan Participants to their Own Devices*, 11 CORNELL J.L. & PUB. POL'Y 361, 373-76 (2002) [hereinafter Stabile, *Freedom to Choose Unwisely*] (providing a complete analysis of how an ERISA § 404(c) plan fiduciary complies with ERISA § 404(c) regulatory requirements and effectively transfers control over plan investment decisions to plan participants).

[132] *See* 29 C.F.R. § 2550.404c-1(d)(2) (stating that "no other person who is a fiduciary with respect to such plan shall be liable for any loss, or with respect to any breach . . . that is the direct and necessary result of that participant's or beneficiary's exercise of control").

those investment alternatives.[133] This retained duty also applies to co-fiduciaries that are not directly responsible for selecting and monitoring investment alternatives where the co-fiduciary's actions enable other plan fiduciaries to imprudently select or monitor investment alternatives.[134] According to the DOL, this retained duty "do[es] not permit fiduciaries to ignore grave risks to plan assets, stand idly by while participants' retirement security is destroyed, and then blithely assert that they had no responsibility for the resulting harm."[135]

Another area of fiduciary liability arises from an ERISA Section 404(c) plan fiduciaries' representations to participants. Under the fiduciary duty of loyalty, plan fiduciaries cannot materially mislead participants.[136] This

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[133] ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B) (2000); 29 C.F.R. § 2550.404c-1(a)(2), (f)(8); 57 Fed. Reg. 46,924 n.27; *see also* Hunt v. Magnell, 758 F. Supp. 1292, 1299 (D. Minn. 1991) (explaining that "a trustee's fiduciary responsibilities with respect to an investment do not terminate upon the conclusion of preliminary investigation and purchase of the asset. ERISA fiduciaries must monitor investments with reasonable diligence and dispose of investments which are improper to keep" (citations omitted)).

[134] ERISA § 405(a); Landry v. Air Line Pilots Ass'n, 901 F.2d 404, 422-23 (5th Cir. 1990); American Fed'n of Unions Local 102 v. Equitable Life Assurance Soc'y of the United States, 841 F.2d 658, 665 (5th Cir. 1988).

[135] Amended Brief of Amicus Curiae Secretary of Labor at 2, Tittle v. Enron Corp., Civil Action No. H-01-3913, http://www.dol.gov/sol/media/briefs/enron brief-8-30-02.htm (Aug. 30, 2002) [hereinafter Amended Brief of Amicus Curiae].

[136] *Id.* at 15 (citing Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) ("[L]ying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA.")); *see also* Becker v. Eastman Kodak Co., 120 F.3d 5, 9 (2d Cir. 1997) (finding that because summary plan description and benefits counselor's advice together amounted to materially misleading information, the fiduciary breached its duty to provide participants with complete and accurate information); Babcock v. Hartmarx Corp., No. 96-3862, 1997 WL 767658, at *3 (E.D. La. Dec. 9, 1997), *rev'd on other grounds*, 182 F.3d 336 (5th Cir. 1999) ("[D]efendant's silence, inaction and misleading advices [sic] constitute a breach of the defendant's fiduciary duty."); Simeon v. Mount Sinai Med. Ctr., 150 F. Supp. 2d 598, 604 (S.D.N.Y. 2001) ("[A] fiduciary may not materially mislead those to whom the duties of loyalty and prudence . . . are owed (ERISA was enacted, in part, to ensure that employees receive sufficient information about their rights under employee benefit plans to make well-informed employment and retirement decisions).") (citations omitted); *In re* Bidermann Indus. U.S.A., Inc., 241 B.R. 76, 90 (Bankr. S.D.N.Y. 1999) ("A misrepresentation is material 'if there is a substantial likelihood that it would mislead a reasonable employee in making an adequately informed retirement decision.' " (quoting *In re* Unisys Corp. Retiree Med. Benefit ERISA Litig., 57 F.3d 1255, 1264 (3d Cir. 1995)).

duty of loyalty also places an affirmative duty on plan fiduciaries to disclose material information necessary to protect participants against threats to plan assets.[137] In the context of company stock investments, however, this retained duty is tempered by existing federal securities laws,[138] which restrict dissemination of nonpublic information and may preclude plan fiduciaries from communicating company financial troubles to participants.[139]

ERISA Section 404(c) plan fiduciaries also retain a duty with respect to the design and implementation of blackout periods. ERISA Section 404(c) regulations indicate that fiduciary liability relief is only available during the time participants are capable of exercising control over their account assets.[140] During any period in which participants' investment ability is restricted or suspended, other than reasonable restrictions placed on the frequency of investment directions,[141] participants are incapable of exercising control over their accounts.[142]

Enron 401(k) Plan participants are among the first to seek damages based on these retained fiduciary duties.[143] Enron 401(k) Plan participants

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[137] 29 C.F.R. § 2550.404c-1(c)(2)(ii) (providing that ERISA Section 404(c) fiduciary liability relief is not available where plan fiduciaries have concealed material information regarding the investment, unless disclosure of such information would violate any provision of federal law or any provision of state law that is not preempted by ERISA); McDonald v. Provident Indem. Life Ins. Co., 60 F.3d 234, 237 (5th Cir. 1995) ("Section 404(a) imposes on a fiduciary the duty of undivided loyalty to plan participants and beneficiaries, as well as a duty to exercise care, skill, prudence and diligence. An obvious component of those responsibilities is the duty to disclose material information.").

[138] *See* 29 C.F.R. § 2550.404c-1(c)(2)(ii).

[139] *Id. But see* Amended Brief of Amicus Curiae, *supra* note 135, at 25-27. DOL argues that this duty is not inconsistent with securities laws, in that the corporate insiders owed a fiduciary duty to disclose material nonpublic information to the shareholders and trading public. Conversely, the DOL argues that Enron plan fiduciaries could have met this duty by eliminating Enron stock as a plan investment alternative and as an employer matching contribution or alerting "regulatory agencies, such as the SEC and the Department of Labor, to the misstatements." *Id.*

[140] *See* 29 C.F.R. § 2550.404c-1(a)(1).

[141] *Id.* § 2550.404c-1(b)(2)(i)(C).

[142] *Id.* See also Medill, *Stock Market Volatility and 401(k) Plans*, *supra* note 113, at 535-43, for a complete analysis of the potential remedies available under ERISA for 401(k) plan participants injured by their employer's breach of fiduciary duty.

[143] *See* Kathleen Pender, *Lawsuits Put Pressure on Companies to Change 401(k) Plan Rules*, S.F. CHRON., Feb. 12, 2002, at B1 ("Employees and former employees of Enron, Lucent Technologies, Ikon Office Solutions, Nortel Networks

filed several lawsuits against Enron, its employee benefits administrative committee, company executives, and Enron's third-party service providers.[144] The Enron class action plaintiffs appear to have a strong case of fiduciary liability given the facts that plan fiduciaries were aware of nonpublic information that raised doubts about the continued viability of an Enron company stock investment alternative,[145] and despite that awareness, they continued to offer the Enron company stock investment alternative, continued to promote Enron company stock ownership, and implemented the scheduled blackout at a time when Enron company stock was in a virtual free fall.[146]

There are, however, numerous reasons why the retained fiduciary duties may not provide adequate protection to Enron 401(k) Plan participants, as well as to any participant-directed 401(k) plan participants. First, once an employer establishes that a plan qualifies as an ERISA Section 404(c) plan,[147] the burden falls on participants to show that plan fiduciaries breached one or more of their retained fiduciary duties.[148] This burden is ill-defined. To date, only two appellate courts have considered fiduciary liability stemming from a plan fiduciary's failure to prudently select and monitor a company stock investment alternative; in both cases, the plans at issue were ESOPs.[149] Both courts held that the objective of encouraging employee stock ownership was secondary to ERISA's objectives of

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and Providian have filed suits alleging breach of fiduciary dut[ies] in their 401(k) plans. All the suits revolve around losses in company stock.").

[144] Consolidated Amended Complaint, Tittle v. Enron Corp. (S.D. Tex. 2002) (No. H-01-3913), http://www.enronerisa.com/pdf/Enron1stConsolidatedAmended Complaint.pdf.

[145] *See Hearings on the Enron Collapse*, *supra* note 6, at 116-18 (statement of Cindy K. Olson, Executive Vice President of Human Resources and Community Relations) (indicating that she was aware of the Sherron Watkins memo, that she met with Ms. Watkins, and arranged a meeting between Ms. Watkins and Mr. Lay).

[146] *Id.* at 104 (statement of Mike Rath, Benefits Manager, Enron Corporation). Rath indicated that Enron plan fiduciaries did consider postponing the eleven-day blackout period based on concerns respecting financial statement disclosures, but determined that more than 20,000 plan participants could not be notified in a timely fashion and, in any event, "would actually take longer to reverse the transition than to finish it." *Id.*

[147] Stabile, *Freedom to Choose Unwisely*, *supra* note 131, at 373-76.

[148] *Id.*; *see also* Medill, *Stock Market Volatility and 401(k) Plans*, *supra* note 113, at 481-82.

[149] Moench v. Robertson, 62 F.3d 553 (3d Cir. 1995); Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995); *see also* Canale v. Yegan, 782 F. Supp. 963 (D.N.J. 1992).

"ensuring the proper management and soundness of employee benefit plans."[150] To accommodate these competing objectives, however, the courts held that there is a presumption that an ESOP fiduciary's investment in company stock complies with ERISA.[151] To rebut that presumption, a plaintiff must show that the plan fiduciary's continued investment in company stock constitutes an abuse of discretion.[152] The application of this "abuse of discretion" standard is unclear, but both courts indicated that factors such as a rapid decline in the price of company stock,[153] plan fiduciary knowledge of the imminent financial collapse of the employer,[154] and the presence of a conflict of interest generated by the plan fiduciary's dual role as a fiduciary and company insider are important considerations in the analysis.[155]

The abuse of discretion standard may be applied to participant-directed 401(k) plans with company stock holdings. While there are policy and design distinctions between ESOPs and 401(k) plans (e.g., the latter is not historically designed for investment primarily in company stock), there is no statutory basis for distinguishing between an ESOP and any other eligible individual account plan with respect to the deference paid to a plan sponsor's selection of a company stock investment alternative. Therefore, courts may ignore the policy and design distinctions between the two plans

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[150] *Kuper*, 66 F.3d at 1457; *see also Moench*, 62 F.3d at 569 ("ESOP fiduciaries must, then, wear two hats, and are 'expected to administer ESOP investments consistent with the provisions of both a specific employee benefits plan and ERISA.'" (quoting Kuper v. Quantum Chem. Corp., 852 F. Supp. 1389, 1395 (S.D. Ohio 1994))).

[151] *Moench*, 62 F.3d at 567-68 ("ESOP plans are formulated with the primary purpose of investing in employer securities" and that "under normal circumstances, ESOP fiduciaries cannot be taken to task for failing to diversify investments, regardless of how prudent diversification would be under the terms of an ordinary non-ESOP pension plan.").

[152] *Id.* at 571 ("[A]n ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision. However, the plaintiff may overcome that presumption by establishing that the fiduciary abused its discretion by investing in employer securities.").

[153] *Id.* at 572.

[154] *Id.*

[155] *Id.* ("[C]ourts should be cognizant that as the financial state of the company deteriorates, ESOP fiduciaries who double as directors of the corporation often begin to serve two masters."); *Kuper*, 66 F.3d at 1459 (holding that ESOP plan fiduciaries did not consider diversification "despite their intimate knowledge of [the company's] financial woes and their awareness that the [the company's CEO] sold his shares [in the company]").

and apply the abuse of discretion standard to 401(k) plan fiduciaries' selection and retention of a company stock investment alternative. Alternatively, even if courts accept that the distinction between 401(k) plans and ESOPs warrants different standards of review, the distinction may be eradicated by employers' conversion of 401(k) plans to KSOPs, under which company stock holdings are held under the ESOP component of the plan (which is designed to invest primarily in company stock and warrants the abuse of discretion standard). While the Enron 401(k) Plan was not designed as a hybrid KSOP, this distinction will not exist for millions of other 401(k) plan participants. Given the lack of a statutory distinction and the proliferation of hybrid KSOPs, 401(k) plan participants may carry a heavy burden of showing that plan fiduciaries abused their discretion—that they knew or should have known that company stock was an imprudent investment offering.[156]

A second reason why the retained fiduciary duties may not provide adequate protection to Enron 401(k) participants is that appellate court decisions have accepted an ERISA Section 404(c) defense argument. This allows plan fiduciaries to escape liability where losses stem from participants' independent investment decisions even when they breach their fiduciary liabilities to prudently select and monitor investment alternatives.[157] In effect, an ERISA Section 404(c) plan fiduciary may be able to insulate herself from fiduciary liability by establishing that there was a "causal nexus between the participant's exercise of control and the claimed loss,"[158] and thus, the plan fiduciary's selection of the company stock investment alternative was not the proximate cause of the participants' losses.[159]

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[156] *See* Susan J. Stabile, *Another Look at 401(k) Plan Investments in Employer Securities*, 35 J. MARSHALL L. REV. 539, 563-64 (2002) (noting a recent decision by the U.S. District Court of Pennsylvannia in *In re Ikon Office Solutions Securities Litigation*, 191 F.R.D. 457, 462 (E.D. Pa. 2000), "[t]he *Ikon* decision suggests that courts will examine a 401(k) plan fiduciary's decision to continue to invest matching contributions in company stock the same way the decision of an ESOP trustee is analyzed").

[157] *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 445 (3d Cir. 1996) (holding that ERISA Section 404(c) "allows a fiduciary, who is shown to have committed a breach of duty in making an investment decision, to argue that despite the breach, it may not be held liable because the alleged loss resulted from a participant's exercise of control").

[158] Stabile, *Freedom to Choose Unwisely*, *supra* note 131, at 377.

[159] *But see* 57 Fed. Reg. 46,906, 46,924 (Oct. 13, 1992). In footnote 27 of the Preamble to its final regulations under ERISA Section 404(c), the DOL takes the position that a participant's exercise of control is not the cause of a loss attributable

Third, even if participants carry the burden of showing that ERISA Section 404(c) plan fiduciaries violated their retained duties by offering or continuing to offer a company stock investment alternative, and that the breach was the proximate cause of participants' losses, plan fiduciaries may be incapable of reimbursing participants' losses. For example, the Enron 401(k) Plan participants suffered over $1 billion in retirement plan losses attributable to Enron company stock holdings.[160] It is unlikely that they will find sufficiently deep pockets to adequately reimburse them for such monumental losses. While Enron carried $85 million in fiduciary liability insurance to cover lawsuits related to benefit plan losses and another $350 million for directors' and officers' insurance "to protect the company and top officials from liability if they are sued,"[161] the availability, as well as the sufficiency, of these and other funds to pay any forthcoming judgment is questionable.

Fourth, the retained duty to prudently select and monitor investment alternatives may become entirely obsolete through plan fiduciaries' selection of self-directed brokerage accounts. In recent years, employers have designed their ERISA Section 404(c) plans to include a self-directed brokerage account,[162] which provides participants with the opportunity to invest in all publicly traded securities, including company stock.[163] Offering self-directed brokerage accounts as an investment alternative reduces plan fiduciaries' liability to participants' underlying investment selections.[164] Arguably, self-directed brokerage account plans can eliminate most

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to the imprudent selection of an investment alternative. *Id.*

[160] *Hearings on the Enron Collapse*, *supra* note 6, at 25.

[161] John Keilman, *No Assurance of Enron Insurance Payouts; Some Firms Try to Void Policies*, CHI. TRIB., Feb. 24, 2002, at 1 ("[T]ypically, money from both kinds of insurance goes first for defense costs, and Enron has already asked a bankruptcy judge for permission to use $30 million to pay the legal expenses of current and former officials. Whatever is left can be used to pay claims, but since the Enron case could drag on for years, the kitty could dwindle to nothing by the time a settlement or judgment is reached.").

[162] Hewitt Associates, *Self-Directed Brokerage Accounts*, *supra* note 10 (study of 290 plan sponsors in the U.S. found that "[m]ore than half of the companies surveyed (55%) currently offer, will add, or are considering adding a self-directed brokerage account within the next 18 months . . . [with a]bout nine in ten plans (89%) that currently offer or will offer the option in the next 18 months allow[ing] participants to trade in individual securities, as well as a broad range of no-load mutual funds").

[163] *See id.* (defining self-directed brokerage accounts).

[164] *See* 29 C.F.R. § 2550.404c-1(b)(1), (2)(i)(A) (2003).

investment-related fiduciary responsibilities unless participants fail to give investment instructions.[165]

3. *401(k) Plan Participants' Inability to Prudently Manage Account Assets*

In the context of 401(k) plans that offer a company stock investment alternative, there are two reasons why participants are failing to prudently invest their account assets: (1) their unfamiliarity with prudent investment practices developed in the field of finance and investment and (2) employer influence over participants' investment decisions. This sub-part addresses the first reason, with the second reason discussed in Part II under the analysis of the House Bill's investment advice proposal.

Assuming that employer-facilitated independent individually-tailored investment advice to participants can promote diversification and prudent investment practices, 401(k) plan participants are not receiving such advice. This is because 401(k) plan fiduciaries are not required to facilitate investment advice as a cost of ERISA Section 404(c) fiduciary liability relief.[166] Part of the reason for the DOL's failure to include an investment advice requirement is the liability distinctions it draws from ERISA's definition of a "fiduciary" and ERISA's prohibited transaction rules. ERISA defines a fiduciary to include any person who renders plan investment advice for a fee.[167] If the types of information provided by the

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[165] *See, e.g.*, Andrea S. Rattner & Elena Eracleous, *Back-Door Way of Investing in Employer Stock*, 17 CORP. COUNS. 1 (2002) (noting that self-directed brokerage accounts may be problematic where the employer's workforce is unsophisticated and not highly educated); Morton A. Harris & William D. Berry, *Working With The Direct Investment Option Under ERISA § 404(c)*, ALI-ABA Course of Study, 1263, 1299 (2002), *at* SH012 ALI-ABA 1263 ("It is felt by many authorities that an 'open option' plan will eliminate all investment-related fiduciary responsibilities of the employer unless a participant fails to give any investment instructions." (citing 29 C.F.R. 2550.404c-1(b)(1), (2)(i)(A))).

[166] 29 C.F.R. § 2550.404c-1(c)(4) (providing that fiduciary has no obligation to provide investment advice to a participant or beneficiary under an ERISA Section 404(c) plan).

[167] ERISA § 3(21)(A)(ii), 29 U.S.C. § 1002(21)(A)(ii) (2003) (providing that a person is a fiduciary to the extent he "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of [a] plan, or has any authority or responsibility to do so"); *see also* 29 C.F.R. § 2510.3-21(c). Under DOL Definitions and Coverage, the meaning of "investment advice" is restricted to circumstances in which the advice relates to the value of the assets or the advisability of the investment transaction, and the investment adviser

plan sponsor or a third party service provider rise to the level of investment advice, then that person is deemed a fiduciary with respect to that investment advice and ERISA Section 404(c)'s fiduciary liability relief is negated for any losses (or potentially inadequate gains).[168] Further, the DOL interprets ERISA's prohibited transaction rules as precluding third party service providers from rendering investment advice on any investment alternative for which the provider may receive an additional fee as a result of the participants' investment decisions.[169] Absent a prohibited transaction exemption, "interested" third party service providers are effectively precluded from independently offering investment advice to participants.[170]

Based on these liability distinctions, ERISA Section 404(c) regulations only require that plan fiduciaries provide participants with "sufficient information" to make informed investment decisions,[171] including information conveying a general description of the investment objectives and risk and return characteristics of each investment alternative.[172] In the context of a company stock investment alternative, the company's most recent prospectus, financial statements, and reports satisfy the sufficient information requirement.[173]

Two subsequent DOL actions aimed at facilitating voluntary investment education and investment advice have not rectified the DOL's initial failure to mandate an investment advice requirement. In 1996, the DOL issued an interpretive bulletin containing safe harbors under which certain

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either has discretionary authority to buy or sell plan property or provides the advice on a regular basis, and pursuant to an agreement or understanding that the advice will serve as a primary basis for plan investment decisions and that such advice will be individualized based on plan needs. *Id.*

[168] *See* ERISA § 3(21)(A)(ii); 29 C.F.R. § 2510.3-21(c).

[169] *See* ERISA § 406(b)(1), 29 U.S.C. § 1106(b)(1) (2003) ("A fiduciary with respect to a plan shall not deal with the assets of the plan in his own interest or for his own account. . . ."); *id.* § 406(b)(3) ("A fiduciary with respect to a plan shall not receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.").

[170] *See, e.g.*, Prohibited Transaction Exemption 92-75, 57 Fed. Reg. 45,832, 45,833 (Oct. 5, 1992). DOL approved of Shearson Lehman's proposal to offer investment advice to participants in plans that used its mutual funds as investment options under a fixed fee arrangement, thus removing any incentive to steer plan participants into Shearson Lehman mutual funds. *Id.*

[171] 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1).

[172] *Id.* § 2550.404c-1(b)(2)(i)(B)(1)(ii).

[173] *Id.* § 2550.404c-1(b)(2)(i)(B)(1)(viii), (2)(ii).

information and materials are deemed "investment education" materials and can be provided to participants without transforming the provider into an ERISA fiduciary or causing interested parties to violate the prohibited transaction rules.[174] Under the safe harbors, plan fiduciaries, including third party service providers, may offer "plan information, general financial and investment information, asset allocation models and interactive investment materials."[175] Then, in 2001, the DOL issued an advisory opinion (the "SunAmerica Opinion")[176] under which interested third party service providers can provide investment advisory services to individual account plan participants without violating ERISA's prohibited transaction rules. To interject a level of independence, however, the interested party investment advice must be based on asset allocation recommendations that are the product of a computer program developed by an independent financial expert.[177]

The 1996 investment education safe harbors virtually guaranteed that participants would not receive investment advice that falls outside of the enumerated safe harbors. This is evidenced by the fact that the vast majority of participant-directed 401(k) plan participants receive only the types of investment education sanctioned by the safe harbors,[178] with such generic investment education playing a limited role in encouraging prudent investment selection.[179] Similarly, while the 2001 SunAmerica Opinion did stimulate interested party investment advisory services for some sectors of

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[174] Interpretive Bulletin Relating to Participant Investment Education, 29 C.F.R. § 2509.96-1 (2003).

[175] *Id.* For a complete analysis of Interpretive Bulletin 96-1's safe harbors, see Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 51-55 (2000) [hereinafter Medill, *The Individual Responsibility Model of Retirement Plans Today*].

[176] Dep't of Labor Advisory Op. 2001-09A, www.dol.gov/dol/pwba/programs/ori/advisory2001/2001-09A.htm (Dec. 14, 2001) [hereinafter SunAmerica Opinion].

[177] *Id.*

[178] PROFIT SHARING/401(K) COUNCIL OF AM., 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS 47 (2002), http://www.psca.org/data/45th.html [hereinafter PSCA 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS].

[179] Robert L. Clark & Madeleine B. d'Ambrosio, *Financial Education and Retirement Savings*, *in* RETIREMENT IMPLICATIONS OF DEMOGRAPHIC AND FAMILY CHANGE SYMPOSIUM 6 (June 2002), *at* http://www.soa.org/library/monographs/retirement_systems/M-RS02-2/M-RS02-2_challenge_III.pdf (citing Leslie Muller, Investment Choice in Defined Contribution Plans: The Effects of Retirement Education on Asset Allocation (2000) (unpublished paper on file with the Social Security Administration, Washington D.C.)).

the 401(k) plan population,[180] it had little impact on 401(k) participants employed by large publicly traded companies, the same companies that are more likely to offer a company stock investment alternative. Because of the associated costs, large publicly traded companies are less likely than smaller companies to offer investment advice.[181] Only approximately 20% of large, publicly traded companies offer some type of investment advice.[182] Additionally, for those participants who do receive investment advisory services under the SunAmerica Opinion parameters, those services are generally limited to rendering advice on mutual fund investment alternatives.[183] Because these services rely on statistical methodology that is not easily adaptable to individual stock offerings,[184] they do not advise participants with respect to individual stocks, such as the employer's company stock.[185]

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[180] *See* PSCA 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS, *supra* note 178, at 52 (indicating that 41.4% of profit sharing and 401(k) plans offer some sort of investment advice, with slightly more than half of the 41.4% providing one-on-one, in-person counseling, 38.3% utilizing internet advisers, and 27.1% making telephone hotlines available).

[181] *Id.* ("Advice is offered most frequently at small companies, and least frequently at large companies. Advice is offered in 55% of plans with fewer than 50 participants, but only in 25.7% of plans with 5,000 or more participants.").

[182] *Id. See also House Education & the Workforce Committee Fact Sheet, Retirement Security Advice Act, at* http://edworkforce.house.gov/issues/107th/workforce/erisa/onepagefs.htm (Nov. 7, 2001) ("Only 16 percent of 401(k) participants have an investment advice option available through their retirement plan."); Profit Sharing/401(k) Council of America (PSCA), *Investment Advice Survey 2001, at* http://www.psca.org/data/advice2001.html (last visited Oct. 24, 2003). In a survey of 141 member companies, respondents indicated that 22% of companies were currently offering investment advice to plan participants. Companies with small (1-49 participants) and medium-sized plans (1000 to 4999 participants) were more likely to offer investment advice (approximately 41%). In contrast, large plans (5000+ participants) are less likely to offer investment advice (15.8%). *Id.*

[183] Paul Katzeff, *More 401(k) Plans Give Specific Advice*, INVESTOR'S BUS. DAILY, Dec. 26, 2002, at A7.

[184] *Id.* ("Our methodology is not designed to do individual stock screenings," quoting Netal Ringquist, executive vice-president for sales, marketing and client service of Mpower.).

[185] *Id.* (noting that neither Mpower nor CitiStreet Advisors, two third-party service providers that developed investment advisory services based upon the DOL's SunAmerica advisory opinion, provides investment advice with respect to individual stocks).

Lacking the financial acuity to make prudent investment decisions,[186] participants are left to their own devices to sift through hundreds of pages of general "investment education" materials, with the result being both overly aggressive and overly conservative investment selections that fail to adequately diversify account assets. The overly aggressive nature of some participants' investment decisions is evidenced by their failure to diversify account assets among numerous investment alternatives. For example, although participant-directed 401(k) plans now offer on average thirteen to fourteen investment options,[187] with an increasing number of plan sponsors offering a brokerage option with virtually unlimited investment options,[188] most participants invest in just two or three investment alternatives with each selected investment concentration significantly more than the recommended 10 to 20% concentration.[189] The overly conservative nature of some participants' investment decisions is evidenced by their failure to achieve gains commensurate with those achieved by institutional investors.

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[186] Medill, *The Individual Responsibility Model of Retirement Plans Today*, *supra* note 175, at 16 ("Research studies indicate that there is a lack of knowledge among the public concerning retirement savings goals, basic investment information, and a realistic assessment of the amount of time likely to be spent in retirement."); *Hearings on the Enron Collapse*, *supra* note 6, at 8 (statement of Elaine L. Chao, Secretary, United States Department of Labor) ("Most people simply don't have the time or the inclination to become experts on managing financial portfolios, even their own."); *Participants Continue To View Company Stock As Lower Risk Equity*, DC PLAN INVESTING, June 1, 2002, *at* 2002 WL 7308763 (citing 2002 John Hancock survey perceiving "a strong lack of investment knowledge and skill on the part of [401(k)] plan participants").

[187] *See* PSCA 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS, *supra* note 178 ("The number of funds offered to plan participants continues to increase. 69.8% of plans offer 10 or more funds for participant contributions, up from 61.5% in 2000 and 51.2% in 1999. The average number of funds available for participant contributions is 14.5%.").

[188] *Id.* (providing 16% of all plans offer a self-directed mutual fund window or brokerage window); *see also* Hewitt Associates, *Self-Directed Brokerage Accounts*, *supra* note 10 (indicating that more than half of the companies surveyed currently offer, will add, or are considering adding a self-directed brokerage account within 18 months from survey date).

[189] Craig Gunsauley, *Unlimited Options*, EMPLOYEE BENEFIT NEWS, *at* http://www.benefitnews.com/retire/detail.cfm?id=3143 (July 2002). This is according to data from PSCA and the Society of Professional Recordkeepers and Administrators ("SPARK"). *Id.*

A 2002 study conducted by the National Center for Policy Analysis[190] found that many participants barely keep up with inflation because they invest too conservatively, as ERISA Section 404(c) investment returns have been 2% lower per year than returns achieved by institutional investors.[191] Other studies indicate that younger employees, those in a better position to invest more aggressively, may be among the most conservative of investors.[192]

While overly aggressive and overly conservative investment selections are imprudent and jeopardize participants' retirement security, it is employers' unfettered ability to offer company stock as an investment alternative that places participants at the greatest risk. The vast majority of participant-directed 401(k) plans with a company stock investment alternative take advantage of the lack of an overall limitation on company stock investment and does not impose any limitation on employee elective deferral contribution investment in company stock.[193] In the absence of plan limitations, participants are incapable of assessing the relative risk and return characteristics of company stock. For example, in a recent survey conducted by the Boston Research Group of 401(k) plan participants with company stock holdings, the majority of responding participants who were aware of the losses suffered by Enron 401(k) Plan participants indicated that they did not believe that their own company stock holdings were excessive, even though one-third of responding participants held 40% or more of their total assets in company stock.[194] According to the survey, participants believed that a 31% company stock concentration was prudent

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[190] News Release, National Center for Policy Analysis (NCPA), People Who Want to Invest Your Money Are Doing a Lousy Job of Investing Their Own, *at* http://www.ncpa.org/prs/rel/2001/nr01dec10.html (Dec. 10, 2001).

[191] *Id.* (noting that lower returns on investments hit low-wage workers the hardest).

[192] *See* Jeff Sommer, *Global Action on Aging, 401(k) Investors Want More Advice*, *at* http://www.globalaging.org/pension/us/private/401.htm (Sept. 22, 2002) (citing July-August 2002 survey by Cigna Retirement and Investing Services that found among the 18 to 25 age group, only 26% reported that they held stocks or stock mutual funds; in contrast, 76% of the 48 to 56 age group held stocks).

[193] *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 6 ("14 percent of those having a company stock investment option in the 401(k) plan reported that they limited the amount or percentage of company stock that employees may hold in their 401(k) plan.").

[194] *See Participants Continue To View Company Stock As Lower Risk Equity*, *supra* note 186 (citing Boston Research Group April 2002 survey).

and that their company stock holdings carried the same or less risk than money market funds, which are considered low risk investments.[195] Other reasons cited for the participants' decisions to continue excessive investment in company stock were the company stock's historical performance and institutionally fostered feelings of employee loyalty.[196]

Exacerbating the problem, almost half of 401(k) plans that offer a company stock investment alternative require employer matching contributions in the form of company stock.[197] Maintaining the excessive concentration, a significant number of these plans restrict participants' ability to diversify 401(k) plan company stock holdings attributable to employer matching contributions.[198] Such was the case with Enron's 401(k) Plan, which made employer matching contributions[199] in the form of treasury shares[200] and restricted diversification of those contributions until participants attained age fifty.[201]

The combined effect of employee elective deferral contributions and employer contributions directed to a company stock investment alternative is that approximately 30% of plan assets are invested in company

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[195] *Id.* (indicating that 50% saw company stock as less risky than tech mutual funds and no riskier than a money market mutual fund; 39% thought company stock had the same or less risk than a government bond mutual fund).

[196] *Id.* (providing that 74% of participants cited stock's historical performance; 54% cited company loyalty); *see also* OLIVIA S. MITCHELL & STEPHEN P. UTKUS, *Company Stock and Retirement Plan Diversification*, *in* THE PENSION CHALLENGE: RISK TRANSFERS AND RETIREMENT INCOME SECURITY 2002, 30 (Pension Research Council Working Paper No. 2002-4, 2002) (citing results of numerous studies with similar findings, on file with author).

[197] Mitchell & Utkus, *supra* note 4, at 11; *see also* PSCA, *Company Stock 2002*, *supra* note 8, at tbl.9 (providing that one-third of respondent plans direct employer matching contributions to the company stock investment alternative).

[198] *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 5 ("Of the 401(k) plans where employer contributions were required to be invested in company stock: 13 percent reported no restrictions existed for selling the company stock[;] 27 percent reported that they were restricted throughout a participant's investment in the plan[;] 60 percent reported that they were restricted until a specified age and/or service requirement is met.").

[199] *Hearings on the Enron Collapse*, *supra* note 6, at 112 (statement of Mike Rath, Benefits Manager, Enron Corporation) (explaining that, beginning in 1998, Enron began making employer matching contributions based on 50% of up to 2% of pay, which was increased in 1999 and again in 2000 to 50% of up to 6% of pay).

[200] *Id.* at 130.

[201] *Id.* at 235 (Article V.16(a)).

stock.[202] The diversification picture becomes increasingly bleak for participant-directed 401(k) plans sponsored by large publicly traded corporations.[203] A recent Congressional study of the Fortune 50 companies found that, on average, 40% of these companies' 401(k) plan assets are invested in company stock, with 30% of these companies' plans more heavily invested in company stock than Enron's 401(k) plan.[204] An earlier survey conducted by IOMA's DC Plan Investing found that twenty-five of the 219 large companies surveyed reported that their 401(k) plans contained a higher company stock concentration than Enron's 401(k) Plan did.[205] Companies such as Procter & Gamble, Sherwin Williams, and Abbott Laboratories all had at least 90% of their plan assets invested in company stock, with Coca-Cola, General Electric, Pfizer, and Anheuser-Busch having more than 70% of their plan assets invested in company stock.[206]

Although a significant portion of the aforementioned plans are actually hybrid plans ("KSOPs") and not stand-alone 401(k) plans,[207] that fact does

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[202] *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 2 (indicating 32% of plan assets are invested in company stock where the plan sponsor does not offer a guaranteed investment contract, and 28% if a GIC is offered under the plan); Mitchell & Utkus, *supra* note 4, at 10 (indicating that of 401(k) plans offering company stock as an investment alternative, 29% of plan assets are invested in company stock); Purcell, *Employer Stock in Retirement Plans*, *supra* note 27, at 9-10 (examining data from large, publicly traded companies sponsoring individual accounts plans, and finding that, on average, 38% of plan assets are invested in company stock).

[203] *See* Munnell & Sunden, *supra* note 3, at 3 (showing 72% of plans with 5000 or more participants offered company stock as a plan investment alternative, with 43.3% of plan assets invested in company stock).

[204] U.S. Senate Democratic Policy Committee Special Report, *The Fortune 50: Company Stock as a Percentage of 401(k) Plan Assets*, released by Senator Byron Dorgan, *at* http://www.democrats.senate.gov/~dpc/pubs/107-2-60.html (last visited Oct. 24, 2003). Exxon Mobil, General Electric, Duke Energy, Kroger, Chevron, Home Depot, Morgan Stanley Dean Witter, Merrill Lynch, Proctor & Gamble, McKesson HBOC, Target, Albertson's, Berkshire Hathaway, and Costco Wholesale all reported 401(k) company stock investment in greater concentration than under Enron's 401(k) plans. *Id.*

[205] *Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans*, DC PLAN INVESTING, Dec. 11, 2001, at 2, www.ioma.com/mr/uploads/DCPIDec01_CoStock.pdf.

[206] *See* Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 4.

[207] *See* Mitchell & Utkus, *supra* note 4, at 7-8 ("Media reports about the concentration of company stock in retirement programs have sometimes confused the difference between ESOPs and 401(k) plans. For instance, some 401(k) plans

not negate the potential devastating impact that excessive company stock holdings can have on plan participants' retirement security or on the minimal retirement benefit being secured by the 401(k) component of the plan. For example, Proctor & Gamble's retirement plan has an ESOP component, a profit sharing component, and a 401(k) component.[208] Collectively, approximately 95% of the plan's assets are invested in company stock.[209] This translates into approximately 5% of the plan's assets being held outside the plan's ESOP component, and only approximately 5% of plan participants' retirement assets diversified among other investment alternatives. This result could not have been envisioned by Congress's endorsement of supplemental ESOPs.

II. CONGRESS' MISGUIDED ATTEMPT TO ENACT MEANINGFUL PENSION REFORM THAT PROMOTES 401(K) PLAN RETIREMENT SECURITY

In a year where corporate scandals highlighted the dangers of 401(k) plan company stock holdings, Congress made little progress toward enacting pension reform. On July 30, 2002, Congress passed the Sarbanes-Oxley Act ("Act"),[210] which contains blackout notification requirements and supersedes blackout proposals contained in numerous pension reform bills introduced in Congress.[211]

With the reintroduction of the Pension Security Act of 2002, the Pension Security Act of 2003 has emerged as the frontrunner for any future pension reform.[212] The House Bill, however, rejects limitations on participant-directed 401(k) plan investment in company stock,[213] which are

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named as having high concentrations of employer stock are actually ESOP-centered programs."). The article goes on to note that Procter and Gamble, Abbott Laboratories, Anheuser-Busch, Ford Motor Company, and Pfizer all sponsor hybrid KSOPs. *Id.* at 8-10.

[208] *Id.* at 8.

[209] *Id.*

[210] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

[211] *See* ERISA § 101(i), 29 U.S.C. § 1021(i) (2002) (as amended by Pub. L. No. 107-204, § 306(b)(1) (enacted on July 30, 2002)).

[212] Joshua H. Sternoff & Nicole K. Watson, *Pension Reform Act I: Accounting Industry Reform Act Enacted; Next Step: Pension Reform Legislation*, 2-3, *at* http://www.realcorporatelawyer.com/sopaulhastings.pdf (2002).

[213] *See* H.R. 3463, 107th Cong. (2002) (proposing a 10% limitation on company stock investment attributable to employee elective deferrals); S. 1838, 107th Cong. (2002), H.R. 3640 & H.R. 3692 (proposing a 20% limitation on company stock investment for each individual account); H.R. 3677 (proposing a

undoubtedly the most effective means of guarding against employer abuses and influences. Instead, it relies on ancillary pension reform measures that theoretically increase participants' ability to gain and assimilate information and act prudently with respect to that information.

Part II provides a critical analysis of the Republican-backed House Bill by analyzing the primary arguments against applying overall limitations to participant-directed 401(k) plans. It also examines select ancillary pension reform proposals contained in the House Bill and the blackout notification requirements enacted under the Sarbanes-Oxley Act, and raises both substantive and procedural questions that challenge the efficacy of these measures to achieve the desired end.

A. *The Unsupportable Rejection of Overall Limitations on Participant-Directed 401(k) Plan Investment in Company Stock*

The House Bill reflects the Bush Administration's acceptance of arguments against overall limitations on 401(k) plan investment in company stock without exploring the legitimacy of these arguments. None of these arguments, however, adequately support the rejection of overall limitations in such plans.

1. *Overestimating the Importance of ERISA Section 404(c)'s "Personal Responsibility/ Freedom of Choice" Component*

The House Bill's failure to mandate overall limitations on 401(k) plan investment in company stock is based in large part on the Bush Administration's acceptance of the "personal responsibility/freedom of choice" argument.[214] Under this argument, overall limitations fly in the face of ERISA and the Internal Revenue Code's ("Code") historical policy of

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20% limitation on elective deferrals for participants with less than three years of participation, and, for all other participants, a 20% limitation on the entire vested account balance); S. 1919 (imposing a 20% limitation).

[214] White House Office of Communications, *Report of the Department of the Treasury on Employer Stock in 401(k) Plans* (Feb. 28, 2002), at *4-7, 2002 WL 313307 [hereinafter White House, *Report on 401(k) Plans*] (rejecting "arbitrary" limitations based on numerous findings, including the finding that limitations fail to consider that individual account plan assets belong to participants and that the government should not arbitrarily restrict how participants choose to invest their own money).

placing investment decisions in the hands of participants, who must be free to invest their own contributions as they see fit.[215]

The personal responsibility/freedom of choice argument is a distortion of the policy goals underlying the creation of ERISA Section 404(c) plans. First, ERISA Section 404(c) is not the embodiment of Congressional judgment that participants are entitled to unfettered control over account assets. ERISA Section 404(c)'s authorization of participant-directed individual account plans originated in a pre-ERISA retirement plan landscape that was dominated by defined benefit plans.[216] When ERISA was enacted, the relatively few individual account plans that were in existence were predominantly profit-sharing plans and ESOPs,[217] which were often utilized to supplement the guaranteed benefits provided by the employer's defined benefit plan.[218] Moreover, these supplemental individual account plans were primarily funded through employer contributions, which were in turn invested by plan fiduciaries that were subject to rigorous fiduciary standards enacted under ERISA.[219] Through ERISA Section 404(c), Congress expressed a willingness to give participants some measure of control over account assets in plans historically relegated to the role of motivating employees rather than providing retirement security.[220]

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[215] *Id.*; *see also* DOL, EMPLOYER ASSETS IN ERISA EMPLOYER-SPONSORED PLANS, *supra* note 28, at 13 (rejecting overall limitations on ERISA Section 404(c) plan asset investment in company stock based upon finding that no limitations should be placed on participants' ability to direct their own individual account plan assets); GAO REPORT, 401(K) PENSION PLANS, *supra* note 28 (rejecting overall limitations in favor of enhanced reporting and disclosure requirements, prescribed education programs, adoption of diversification requirements, and the use of independent fiduciaries to examine investment decisions).

[216] *See* Mitchell & Utkus, *supra* note 4, at 3 ("DC plans consisted mainly of profit-sharing plans to which employers made variable plan contributions based on company earning, and [ESOPs] which by design encouraged employers to make employer stock contributions in an effort to foster employee ownership. DC plans were thus not widely used as a retirement income vehicles [sic] and at many large firms, they were supplemental to DB programs.").

[217] *Id.*

[218] *Id.*

[219] *See supra* text accompanying notes 71-80 (explaining employee ownership in context of supplemental individual account plans).

[220] *See* S. Rep. 93-383, at 33 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4889, 4918 (stating that the limitation on investment by plans in company stock does not apply to profit-sharing and stock bonus plans because such plans are intended as an incentive to employees by allowing them to share in the profits of the company);

Even in this limited role, however, ERISA's legislative history indicates that Congress did not accept the unfettered personal responsibility/freedom of choice argument in the context of company stock holdings. Instead, Congress expressed reservations about ERISA Section 404(c)'s underlying premise that participants can, in fact, exercise independent control over their account assets where company stock is offered as an investment alternative.[221] Based on those reservations, Congress questioned the administrative feasibility of such plans and came to a preliminary conclusion that a company stock investment alternative may be imprudent.[222] Congress did not, however, proscribe company stock investments, but instead placed the onus on the DOL to address the matter under ERISA Section 404(c) regulations.[223]

The DOL finally responded to Congress' mandate on September 3, 1987, with proposed regulations to ERISA Section 404(c).[224] Citing the conference reports' concerns about participant-directed investment in company stock,[225] the proposed regulations did not provide fiduciary liability relief under ERISA Section 404(c) to participant-directed investment in company stock.[226] The DOL did, however, invite comments on the issue of whether participant-directed investment in company stock

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S. Rep. 93-127, at 34 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4869 (explaining that limitation on company stock and general principles of diversification do not apply to profit sharing plans in recognition of their "special purpose").

[221] H.R. Rep. 93-1280, at 305 (1974) ("Because of the difficulty of ensuring that there is independence of choice in an employer established individual retirement account, it is expected that the regulations will generally provide that sufficient independent control will not exist with respect to the acquisition of company stock by participants and beneficiaries under this type of plan.").

[222] *Id.*

[223] *Id.*

[224] *Proposed Reg. Respecting Participant Directed Individual Account Plans (ERISA Section 404(c) Plans)*, 52 Fed. Reg. 33,508 (Sept. 3, 1987), 1987 WL 140902.

[225] *Id.* at 33,513.

[226] *Id.* ("The proposed regulation does not provide relief under section 404(c) with respect to these investments because the Department does not believe that it has sufficient information to determine if it is appropriate to apply section 404(c) to participant-directed investments which may benefit a plan sponsor, or to determine the kinds of safeguards that might be appropriate to assure that participants are not subjected to undue influence with respect to such investments.").

should be allowed while limiting investment to a specified percentage of overall account balances.[227]

Following the receipt of more than 230 letters of comment and a public hearing where numerous speakers were permitted to testify on the appropriateness of granting ERISA Section 404(c) relief to participant-directed investment in company stock,[228] the DOL issued revised proposed regulations.[229] Under the revised proposed regulations, the DOL extended ERISA Section 404(c) protection to participant-directed investment in company stock under numerous conditions, including the requirement that activities related to the purchase and sale of company stock be the responsibility of an independent fiduciary (a fiduciary not affiliated with any plan sponsor) who carries out such activities on a confidential basis.[230]

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[227] *Id.* The proposed regulation states:

> [T]he Department recognizes that many participant-directed plans do . . . contemplate that section 404(c) would apply to at least some participant decisions to invest in property acquired from an employer and in employer securities and employer real property. Thus, the Department specifically invites comments addressing the issue. Such comments should assist the Department in developing a final rule that will limit the potential for the exercise of improper influence by the plan sponsor, but not unduly restrict participant investment options. The Department is particularly interested in comments describing current practices with respect to property acquired from or sold to plan sponsors, the benefits of such investments and the safeguards which exist with respect to such investments.
>
> With respect to employer securities, the Department is particularly interested in commentators' views concerning whether a participant's investments should be limited to a specified percentage of his account balance and/or whether such investments should be limited to publicly-offered securities.

Id.

[228] *Participant Directed Individual Account Plans*, 56 Fed. Reg. 10,724 (Mar. 13, 1991) (explaining that numerous commentators have suggested sufficient safeguards, including limiting relief to publicly-traded securities, the availability of other investment alternatives, limiting the percentage of any participant's account that could be invested in company stock, limiting the total outstanding number of any class of securities that may be held by the plan at any time, prohibiting plan sponsor solicitation and exhortation of participants with respect to investment in company stock, passing through the incidents of stock ownership to participants, and the use of independent fiduciaries to implement the purchase and sale of company stock).

[229] *Id.*

[230] *Id.*

Although the DOL initially believed that the appointment and involvement of an independent fiduciary was critical for ensuring the meaningfulness of independent control by participants, with respect to company stock investment,[231] the DOL retreated from this position and eliminated the independent fiduciary requirement from the final ERISA Section 404(c) regulations.[232] Instead, the final regulations included a requirement that an ERISA Section 404(c) plan implement procedures designed to safeguard the confidentiality of information relating to company stock holdings, and that such plans designate a plan fiduciary to monitor plan compliance with these procedures.[233] The appointment of an independent fiduciary is only required when a plan fiduciary, who is affiliated with the plan sponsor, determines that a situation exists, such as a tender offer, exchange offer, or contested board election, that raises the potential for undue employer influence over participants.[234]

The DOL's failure to revisit the overall limitations on company stock investment, in light of its retreat from an independent fiduciary requirement, essentially ignored past congressional concerns about potential employer abuses surrounding company stock investment. Given that ERISA Section 404(c) plans are no longer relegated to supplemental plan status and are now riddled with the types of administrative and independent control problems that initially raised congressional concerns, it is reasonable to interpret ERISA as supporting limitations on participants' ability to invest in company stock.

The personal responsibility/freedom of choice argument also ignores the tax-subsidized nature of ERISA Section 404(c) plans. For over seventy-five years, federal tax policy has encouraged employers to voluntarily utilize qualified retirement plans in order to ensure greater retirement security for all American workers. This encouragement has come in the form of direct and indirect tax subsidization of qualified retirement plans. Employer contributions made to a tax-qualified retirement plan are deductible by the employer.[235] Further, employer contributions, employee elective deferral contributions made under a 401(k) plan, and income earned on trust fund assets are not taxed until ultimately distributed to

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[231] *Id.* at 10,735.

[232] Final Reg. Respecting Participant Directed Individual Account Plans (ERISA Section 404(c) Plans), 57 Fed. Reg. 46,906, 46,926 (Oct. 13, 1992).

[233] *Id.* at 46,926-27.

[234] *Id.* at 46,932.

[235] I.R.C. § 404 (2000).

participants.[236] This tax preference significantly reduces taxes paid by American workers who receive part of their overall compensation through their employers' qualified retirement plans, and significantly increases taxes paid by all American workers, including the half of the American workforce that does not benefit from employer-sponsored retirement plan coverage.[237]

This tax preference is identified as a "tax expenditure"[238] in yearly reports published by the staff of the Joint Committee on Taxation and the Office of Management and Budget.[239] The Joint Committee on Taxation

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[236] *Id.* §§ 402(a), 404(a), 501(a).

[237] *Present Law and Background Relating to Employer-Sponsored Defined Benefit Plans*, Jt. Common Taxn. Print JCX-71-02, at 28, *at* http://www.house.gov/jct/x-71-02.pdf (Jun. 18, 2002) ("48 percent of private sector employees participated in employer-sponsored qualified retirement plans . . . among full-time employees, participation was 56 percent.") (citing Bureau of Labor Statistics, National Compensation Survey, Employee Benefits in Private Industry, 1999); *see also* Munnell et al., *supra* note 34, at 3 (showing that the number of American workers covered by some form of pension plan has remained nearly constant for twenty-five years, at approximately 50% of the private sector workforce aged twenty-five to sixty-four).

[238] Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." Thus, the definition of "tax expenditure" encompasses special or preferential provisions of the Internal Revenue Code that benefit certain groups of taxpayers at a cost to all taxpayers. *Cong. Budget and Impoundment Control Act of 1974*, Pub. L. No. 93-344, § 3(3), 88 Stat 297 (1974); *see also* Jonathan Barry Forman, *Comparing Apples and Oranges: Some Thoughts on the Pension and Social Security Tax Expenditures*, 5 EMPLOYEE RTS. & EMP. POL'Y J. 297, 314-15 (2001) ("[W]ith respect to pensions, the cash-flow method estimates the taxes that 'should' be collected on contributions to pension plans and the income earned on pension assets, but it does not measure the value of deferral of income as benefits accrue. Put simply, 'no value is placed on the pension promise itself, only on the advance funding of that promise.' ") (footnote omitted); Dallas L. Salisbury, *The Cost and Benefits of Pension Tax Expenditures*, *in* PENSION FUNDING & TAXATION: IMPLICATIONS FOR TOMORROW 85, 88 (Dallas L. Salisbury & Nora Super Jones eds., Employee Benefit Research Institute, 1994).

[239] JT. COMM. ON TAXN., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2002-2006, http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2002_joint_committee_on_taxation&docid=f:76452.pdf (Jan. 17, 2002); White House, *Office of Mgt. and Budget, Analytical Perspectives: Budget of the U.S. Govt., Fiscal Year 2003*, http://www.whitehouse.gov/omb/budget/fy2003/pdf/

identifies the tax expenditure for qualified plans as the largest single tax expenditure[240] and estimates that for the 2002 through 2006 fiscal years the revenue loss attributable to the net exclusion of pension contributions and earnings under employer plans will be $445 billion.[241] The Office of Management and Budget identifies the net exclusion of pension contributions and earnings as among the highest reported tax expenditures[242] and estimates the net exclusion of pension contributions and earnings under employer plans to be $615 billion for the 2003 through 2007 fiscal years.[243]

Given the fact that the federal government is providing billions of dollars in tax breaks to qualified retirement plan sponsors and participants, and that all Americans, including those that do not reap the benefits of qualified retirement plan coverage, are paying higher taxes to subsidize forgone revenues, federal tax policy discredits the argument that ERISA Section 404(c) plan assets belong solely to the respective participants and that investment decisions are their private financial decisions. Federal tax policy mandates that pension reform measures ensure retirement security for American workers, and that these measures do not continue to foster a forum in which participants can invest their own and the federal government's assets (deferred tax liability) in an imprudent manner.

2. *Overestimating the Negative Impact of Implementing Overall Limitations on ERISA Section 404(c) Plan Investment in Company Stock*

The House Bill's failure to mandate overall limitations on 401(k) plan investment in company stock is based also on the Bush Administration's

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spec.pdf (last visited Oct. 1, 2003) [hereinafter OMB, *Budget*].

240 ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2002-2006, *supra* note 239, at 27.

241 *Id.* (noting that the $445 billion estimate does not include many other tax expenditures relating to qualified retirement plans, including a $78.5 billion estimate for individual retirement plans, a $29.3 billion estimate for Keogh plans, and a $5.7 billion estimate for special tax provisions for employee stock ownership plans).

242 OMB, *Budget*, *supra* note 239, tbl.6-1, at 100 (explaining that the exclusion for pension contributions is divided into a net exclusion of pension contribution and earnings for 401(k) plans and a separate exclusion for employer plans; if the separate rankings were combined, then the net exclusion of pension contributions and earnings is the highest tax expenditure under the OMB rankings).

243 *Id.* The $615 billion estimate for fiscal years 2003 through 2007 includes tax expenditures relating to employer plans, including 401(k) arrangements. *Id.*

acceptance of a deterrence argument.[244] There are several components to this argument, each of which points to several deleterious effects on plan sponsorship and plan participation. Under one component of this argument, overall limitations that restrict an employer's ability to make employer contributions in the form of company stock will deter employers from making employer matching contributions, thus negatively impacting plan sponsorship and plan participation.[245] The basis of this component is that employer contributions, including employer matching contributions, made in the form of existing treasury shares of company stock, impose no immediate cash cost on the company and are not included on the company's income statement, yet the contributions provide the company with an immediate tax deduction equal to the fair market value of the shares at the time they were contributed to the plan (without discounting the value for any restrictions imposed under the terms of the plan).[246] Because of these purported benefits, opponents of overall limitations argue that employers are less likely to make employer contributions in the form of cash.[247]

There are numerous facts that undercut the validity of this argument; the most important is that overall limitations can be implemented without restricting employers' ability to make employer matching contributions in the form of company stock. For example, the Senate Finance Bill[248] contains a "choice" proposal under which employers can continue making employer matching contributions in the form of company stock so long as

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[244] White House, *Report on 401(k) Plans*, *supra* note 214, at *1-2 (reporting that limitations disrupt markets for certain large, publicly traded companies, as substantial amounts of stock in certain companies would have to be sold immediately in order to comply with the imposed limitation; arbitrary caps on individual 401(k) account holdings in employer stock would have a potentially severe disruptive effect on the stock prices of several major companies, with as many as one in five 401(k) participants forced to change their investment allocations if employer stock holdings were limited to 20%; limitations discourage employer matching contributions, which in turn discourages plan participation).

[245] Coalition on Employee Retirement Benefits, *Letter to Members of the United States Congress*, at 2, http://www.americanbenefitscouncil.org/documents/final_cerb_letter_3_1_02.pdf (Feb. 25, 2002) [hereinafter CERB, *Letter to Congress*] ("Percentage caps, limits on holding periods, and diversification mandates will limit employee choice and deter employer matches.").

[246] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 4-5.

[247] *See* CERB, *Letter to Congress*, *supra* note 245.

[248] S. 1992, 107th Cong. (2002).

participants are not allowed to direct employee elective deferral contributions into a company stock investment alternative.[249]

Additionally, employer contributions made in the form of company stock have an immediate cost. Employer contributions made in the form of treasury shares dilute share value.[250] Further, these contributions are often made with shares purchased on the open market and not through treasury shares.[251]

Even if employers are restricted from making employer contributions in the form of company stock, there are numerous reasons why they will instead make those contributions in the form of cash. Employer matching contributions attract new employees and encourage current employees to participate in and contribute to the plan.[252] To the extent that increased plan participation is attributable to lower-paid employees, there is an increased likelihood that the plan will satisfy Code nondiscrimination requirements,[253] even where higher paid employees are receiving and making substantial contributions under the plan. These facts encourage employer matching contributions made in the form of cash.

Under a second component of the deterrence argument, overall limitations on company stock will place significant administrative burdens on plan fiduciaries, including running individual account computations

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[249] *Id.* § 102.

[250] Mitchell & Utkus, *supra* note 4, at 17 ("By issuing new shares and contributing them directly to the plan, the firm avoids spending cash on a matching contribution. Issuing new shares preserves cash flow, so this approach might be expected to be popular among cash-strapped firms. The dilemma, of course, is that issuing new shares to the retirement plan dilutes existing shareholders' interest; economically, the firm's net present value has been reduced, whether the contribution is in cash or in stock.").

[251] Shlomo Benartzi, *Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock*, 56 J. FIN. 1747, 1750 (2001), http://www.anderson.ucla.edu/faculty/shlomo.benartzi/excessive.pdf (stating that one-third of all firms buy stock in the open market to finance individual account plan contributions, while the two-thirds issue new shares).

[252] *See* White House, *Report on 401(k) Plans*, *supra* note 214, at *3 ("Research shows that employees themselves are more likely to participate in their company's 401(k) plan when their employer offers matching contributions."); U.S. GEN. ACCOUNTING OFF., 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME, GAO/HEHS-98-5, at 5 (Oct. 1997) (employer matching contributions increase plan participation by approximately 20%).

[253] I.R.C. § 410(a) & (b) (2000) (minimum participation standards).

annually and requiring a large number of participants to sell company stock held in excess of imposed limitations.[254] These burdens, which are present only where overall limitations come in the form of a percentage limitation, are overestimated. Among other things, snapshot testing, which essentially looks at a single day during the plan year, can be used to determine compliance with overall limitations.[255] Further, benefit statements that reflect individual account plan asset allocations can be used for purposes of determining whether a certain account contains an excessive concentration in company stock.[256] The prospective phase-in of overall limitations could effectively mitigate administrative burdens and market fluctuations arising from the immediate imposition of overall limitations.

Under a third component of the deterrence argument, overall limitations are tantamount to a level of over-regulation that discourages publicly traded companies from establishing or maintaining 401(k) plans. In support, opponents of overall limitations trace the decline of traditional defined benefit plans to the enactment of laws that made defined benefit plan sponsorship more burdensome and costly.[257] Over the more than twenty-five years since its enactment, ERISA has been amended numerous times, including amendments that raise the Pension Benefit Guaranty Corporation's defined benefit plan insurance premium rate, increase the minimum and maximum funding standards for defined benefit plans, and require pension accruals or allocations for previously excludable employees.[258] The majority of these amendments, however, increase the funding and administrative costs of sponsoring traditional defined benefit plans. They are fundamentally different from overall limitations on company stock,

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[254] White House, *Report on 401(k) Plans*, *supra* note 214, at *7 (estimating that one out of every five 401(k) participants "may have to sell employer stock if caps were imposed," which "would precipitate the sale of hundreds of millions of shares" and a disruption of the market that could affect the stock price of certain large corporations).

[255] Snapshot testing has been utilized to determine whether qualified plans meet the I.R.C.'s nondiscrimination requirements, where plans select a representative day of the employer's workforce and plan coverage. *See* Rev. Proc. 93-42, § 3, 1993-31 I.R.B. 32.

[256] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 5-6.

[257] Sylvester J. Schieber et al., *Stretching the Pension Dollar: Improving U.S. Retirement Security and National Saving by Enhancing Employer-Based Pension Plans*, 3 *at* http://www.americanbenefitscouncil.org/documents/pensionpaper.pdf (1999).

[258] *See* EBRI, *Facts from EBRI, History of Pension Plans*, *supra* note 53.

which can be designed to have a negligible impact on funding and administrative costs, as noted above. Thus, there is little anecdotal evidence that implementing overall limitations on 401(k) plan investment in company stock rises to the level of excessive governmental intervention that results in reducing employer sponsorship and employer contributions to these plans.

3. *Overvaluing ERISA's Secondary Federal Policy Goal of Promoting Employee Ownership*

The House Bill's failure to mandate overall limitations on 401(k) plan investment in company stock is also based on the Bush Administration's acceptance of the employee ownership argument, which essentially provides that overall limitations will negatively affect ERISA's policy goal of promoting employee ownership in individual account plans.[259] As previously noted, this argument is a distortion of ERISA's secondary federal policy goal that was relegated to supplemental individual account plans.[260] Further, ERISA's employee ownership goal cannot be attributed to 401(k) plans, which were nonexistent at the time of ERISA's enactment.[261] Assuming that the federal policy goal of employee ownership has some role in 401(k) plans, however, this sub-part addresses the main arguments for promoting employee ownership through 401(k) plan investment in company stock and how these arguments fail to justify unfettered company stock investment.

One of the touted benefits of 401(k) plan investment in company stock is the positive correlation between company stock ownership and employee productivity, which in turn benefits the employer and company shareholders, including employee-shareholders.[262] Theoretically, investment in

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[259] White House, *Report on 401(k) Plans*, *supra* note 214, at *3 ("Many companies believe that giving employees company stock builds their employees' loyalty to the company and gives them a greater economic incentive to work to promote the company's long-term economic prospects.").

[260] S. Rep. 93-127, at 2 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4838, 4839 (explaining the historical justification for individual account plan investment in company stock).

[261] *See* Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763 (1978) (identifying the Revenue Act of 1978 as the law creating 401(k) arrangements).

[262] *Hearings on Enron and Beyond Enhancing Worker Retirement Security*, *supra* note 119 (testimony of Dr. Douglas Kruse, Professor, School of Management & Labor Relations, Rutgers University) ("Employee ownership has attracted attention and interest for a wide variety of reasons. Much of the interest

company stock leads to company productivity gains because of employees' perceived connection between their individual efforts and company stock value.[263]

Evidence of a positive correlation between increasing levels of employee ownership and employee productivity is tentative, at best. Numerous studies have examined the relationship between employee stock ownership and employee productivity in the context of stand-alone ESOPs. Because these plans are designed to invest primarily in company stock,[264] and thus generally have a large percentage of plan assets invested in company stock, any positive correlation between employee ownership and employee productivity should be more discernible. But, the vast majority of these studies found no statistically meaningful correlation between increased levels of employee ownership and employee productivity.[265]

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has focused on the potential for better economic performance, particularly through enhanced motivation and commitment from employees who have a direct stake in the firm[s'] performance. Strong majorities of the public believe that employee-owners work harder and pay more attention to the quality of their work than non-owners. . . . "); *Hearing on Retirement Security Before H.R. Comm. on Ways and Means Subcomm. on Oversight Comm.*, 107th Cong. (Mar. 5, 2002) (statement of Gene Little, Senior Vice President, Finance, Timken Company) ("Company stock in 401(k) plans has been a powerful contributing factor to the economic outperformance enjoyed by the U.S. economy relative to other industrialized nations over the past decade. It brings about alignment with the company among its associates. It makes associates owners, a tremendous catalyst for productivity and company stock as a benefit, is as you know, an important enabler for start up companies.").

[263] *Hearings on Enron and Beyond Enhancing Worker Retirement Security*, *supra* note 119.

[264] *See* ERISA § 407(c)(6), 29 U.S.C. § 1107(c)(6) (2003) (defining employee stock ownership plan).

[265] *See, e.g.*, Joseph Blasi et al., *Employee Stock Ownership and Corporate Performance Among Public Companies*, 50 INDUS. & LAB. REL. REV. 60, 78 (1996) (comparing corporate performance in 1990/91 of two groups of public companies, those in which employees owned more than 5% of the company's stock and all others and reaching conclusions consistent with prior employee ownership studies: (1) "there is clearly no automatic connection between employee ownership and performance" and (2) "where differences do exist [between the two groups of companies], they tend to indicate better performance by [employee-owned companies]."); Richard L. Doernberg & Jonathan R. Macey, *ESOPs and Economic Distortion*, 23 HARV. J. ON LEGIS. 103, 127-29 (1986) ("A number of empirical studies have attempted to measure the effects of ESOPs on employee productivity. While ESOP proponents have pointed to some of this research as providing compelling evidence that ESOPs are a proven success at raising worker morale,

Before recent congressional hearings on Enron,[266] Professor Douglas Kruse, a preeminent authority on employee ownership, noted that over seventy empirical studies have been conducted over the last twenty-five years on the effects of employee ownership on employee productivity. Based on his review of these studies, Professor Kruse concluded, among other things, that while employee ownership does have some positive effects on employee attitudes and firm productivity, higher levels of organizational commitment and identification are present regardless of the size of the employee-owner's stake in the company.[267] Professor Kruse's conclusions indicate that excessive 401(k) plan investment in company stock is unnecessary to achieve the desired result of marginally increased employee productivity.

A second touted benefit of employee ownership is that employees are more familiar with a company stock investment alternative and, by looking at its historical performance, invest in company stock when it outperforms the gains derived from other plan investment alternatives.[268] As evidenced by the devastating losses suffered by Enron and WorldCom 401(k) plan participants, there is no evidence that employees have any quantifiable familiarity with company stock as an investment alternative.[269] Moreover,

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motivation, and output, a more balanced view recognizes that 'there has been no conclusive evidence . . . indicating that ESOPs serve as powerful employee motivators or effective productivity enhancers.' ") (citing numerous studies with conflicting findings with respect to ESOPs' effectiveness on employee productivity); Elana Ruth Hollo, *The Quiet Revolution: Employee Stock Ownership Plans and Their Influence on Corporate Governance, Labor Unions, and Future American Policy*, 23 RUTGERS L.J. 561, 593 (1992) ("While no evidence suggests that ESOPs hurt productivity, the evidence which suggests that ESOPs increase productivity is not particularly strong either. The types of ESOPs that are growing in number, namely the large corporate plans, appear to have had little impact on productivity.").

[266] *Hearings on Enron and Beyond Enhancing Worker Retirement Security*, *supra* note 119 (testimony of Douglas Kruse, Professor, School of Management & Labor Relations, Rutgers University).

[267] *Id.*

[268] *Pension Plan Overhaul in Wake of Enron Collapse: Hearings on H.R. 10 Before the House Subcomm. on Employer Relations of the Comm. of Educ. and Workforce*, 107th Cong. 33-37 (2002) (statement of Angela Reynolds, Director of International Pension and Benefits at the Dayton, Ohio based NCR Corporation, testifying on behalf of the American Benefits Council).

[269] Contrary to finding that employees are more familiar with a company stock investment alternative, recent studies indicate that employees do not believe that company executives are honest and forthright and therefore employees gain no

there is no evidence that company stock outperforms other 401(k) plan investment alternatives. Studies have found that, on average, the expected rate of return on company stock investments is no greater than the rate of return on diversified portfolios with less inherent risk.[270]

A third purported benefit of employee ownership is that it transforms employees into "stakeholders" with a significant voice in company management decisions.[271] The National Center for Employee Ownership ("NCEO") cites employee majority ownership of such companies as Lifetouch, TTC, Inc., Publix Supermarkets and Science Applications as proof that employees are becoming serious stakeholders in their employers.[272] Yet, the NCEO's own statistics reveal that of the 2200 401(k) plans it estimates are primarily invested in company stock, 90% of these plans have less than a 10% ownership stake in the company.[273] Other statistics indicate that employees attain only a marginal ownership interest in their respective employers through their 401(k) plan investment in company stock with that marginal interest doing more to help entrenched

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specialized knowledge because of the employment relationship. *See Business Week/Harris Poll: How Business Rates: By the Numbers*, BUS. WEEK, Sept. 11, 2000, http://www.businessweek.com:/2000/00_37/b3698004.htm?scriptFramed (citing a June 2000 poll conducted by Harris Interactive Inc. and Business Week, which reported that 74% of respondents did not believe that business does a good job at being straightforward and honest with consumers and employees).

270 Purcell, *Employer Stock in Retirement Plans*, *supra* note 27, at 10 ("[F]or any given expected rate of return, there exists a diversified portfolio of assets that will provide *the same expected rate of return* with *less risk* to the investor than a portfolio concentrated in company stock. Economists have estimated that a portfolio invested in the stock of a single firm listed on the New York Stock Exchange is, on average, twice as risky in terms of price volatility as a well-diversified portfolio of stocks.") (citing Lisa Meulbroek, *Company Stock in Pension Plans: How Costly Is It?* (Harvard Bus. Sch., Working Paper No. 02-058, Mar. 2002)).

271 *Hearings on the Enron Collapse*, *supra* note 6, at 7-8 (statement of Elaine L. Chao, Secretary, United States Department of Labor) ("Our modern economy is far from being perfect, but one of the wonders of the American system is that an administrative assistant from Microsoft or Home Depot or General Electric can become a millionaire by working hard, sticking with their company and investing in it, and having a good investment strategy.").

272 National Center for Employee Ownership, *A Comprehensive Overview of Employee Ownership*, *at* http://www.nceo.org/library/overview.html (Oct. 1, 2002).

273 National Center for Employee Ownership, *A Statistical Profile of Employee Ownership*, *at* http://www.nceo.org/library/eo_stat.html (last updated Apr. 2002) (data drawn from a 1995 NCEO survey of 401(k) plans).

management than to transform employees into employee-owners with a significant voice in company management and policy.[274]

Based upon the questionable benefits derived from 401(k) plan company stock investment, ERISA's employee ownership goal cannot serve as a foundation for rejecting overall limitations on such investment, particularly where that goal can be attained outside the context of tax-subsidized 401(k) plans. Increased productivity can be attained by increasing employee involvement and control in a company's decision-making process,[275] including representation on a company's board of directors and employee benefits committees.[276] Employee ownership goals

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[274] *See* Mitchell & Utkus, *supra* note 4, at 19 ("For 65 of the largest corporate DC plans in the US, we have calculated employee holdings as a percent of outstanding market capitalization. In that sample, DC plan participants controlled some 5.9 percent of the outstanding market capitalization of the average firm. These data represent only DC company stock holdings and exclude other types of stock ownership plans such as employee stock purchase plan[s] and stock options; they also exclude unallocated shares in leveraged ESOPs that the employees may indirectly control. In a tight takeover battle, a 6 percent position held by employees might be very influential (presumably only if employees act in concert). Combined with other employee holdings and stock held by senior management, the total figure of employee-owned stock could be very significant. Nonetheless, overall, the data indicate that DC participants own a small minority holding in the largest firms."); Munnell & Sunden, *supra* note 3, at 6 (finding that among the Fortune 100 companies, employee holdings of company stock as a share of total company stock averaged 7%).

[275] *See* Brett McDonnell, *ESOPS' Failures: Fiduciary Duties When Managers of Employee-Owned Companies Vote to Entrench Themselves*, 2000 COLUM. BUS. L. REV. 199, 235 ("The empirical literature on ESOPs and worker ownership suggests that ownership alone does little to improve productivity. While some studies do find improvement, others do not, and the latter are analytically sounder than the former. Overall, employee ownership alone at most increases productivity only a small amount, and even that small increase is hard to demonstrate. However, employee ownership combined with efforts to encourage greater employee participation in decision-making does seem to increase productivity significantly.") (citations omitted).

[276] *See Hearings on the Enron Collapse*, *supra* note 6, at 134 (testimony of Teresa Ghilarducci, Ph.D., Associate Professor, Department of Economics, University of Notre Dame). Advocates of employee ownership as a means to align employee/employer interests whole-heartedly reject employee representation on plan administrative and employee benefits committees. Based on her extensive research in the area, Dr. Ghilarducci found that the United States is the only industrialized nation that does not mandate employee representation on such committees. "In about half the countries, the employees represent half of the

can also be achieved through alternative tax-favored mechanisms, such as employee stock bonus plans or employee stock options.[277] Moreover, alternative mechanisms have the added benefit of mitigating a phenomenon known as the free rider problem. Particularly with respect to large publicly traded companies, many experts have noted that employees have little incentive to increase their productivity where the benefits of increased productivity will be disseminated to all employees, regardless of their own individual efforts and ownership stake.[278] Where employee ownership is linked to each individual's productivity through alternative tax-favored mechanisms, productivity gains should theoretically evidence a significant increase.

B. *The Unsupportable Reliance on Ancillary Pension Reform Measures*

1. *Overvaluing the Benefits Derived From Diversification Rights*

The House Bill contains a proposal giving participants the immediate right to diversify employee elective deferral contributions previously invested in company stock, and, after a three-year period, the ability to diversify any other contributions (e.g., employer matching contributions) made in the form of company stock.[279] In contrast to leading pension reform bills introduced in the Senate,[280] the House Bill liberalizes the three-year

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trustees, and in this country, 8 percent of pension plans have joint trustees. Those are the ones that unions and management negotiate jointly." *Id.*

[277] *See, e.g.*, Susan J. Stabile, *Pension Plan Investments in Company Stock: More is Not Always Better*, 15 YALE J. ON REG. 61, 75 (1998) (discussing alternative mechanisms for employee ownership).

[278] *See* McDonnell, *supra* note 275, at 234 ("In all but the smallest companies there is a free rider problem—what worker owners should want is for everyone else to work harder while they reap the benefits. . . . Even where the increased output from one employee's input exists and is measurable, the worker has highly imperfect incentives because that increased output is divided among all the other owners. A worker bears all the cost of her increased effort, but gains only a fraction of the benefit. The incentive to work harder thus becomes dimmer and dimmer as the company becomes larger.").

[279] H.R. 1000, 108th Cong. § 104 (2003).

[280] S. 1971, 107th Cong. § 101 (2002) (providing a three-year diversification requirement phased in only with respect to company stock holdings beginning before January 1, 2003); S. 1992, 107th Cong. § 102 (providing that plan participants with three years of service are given right to divest company stock holding attributable to employer contributions, with no transition rules for implementation of three year diversification requirement).

diversification requirement by giving plans the option of allowing diversification of employer contributions as of a participant's completion of three years of service or no later than three years after the end of the plan year in which the contribution was allocated to each participant's account.[281] Further diluting the three-year diversification right, the House Bill phases in this requirement over a five-year period for company stock held by the plan as of the date the requirement is enacted into law.[282]

Although guaranteeing participants the ability to diversify account assets has been promoted as the answer to the current lack of diversification,[283] there are two primary reasons why this uncontroversial approach is likely to have little, if any, impact on plan asset diversification. First, with respect to the immediate diversification right that applies to employee elective deferral contributions previously invested in company stock, current law already restricts an employer's ability to require that more than 10% of employee elective deferral contributions be invested in company stock.[284] The vast majority of participant-directed 401(k) plans do not take advantage of this 10% restriction, do not impose any diversification restrictions on employee elective deferral contributions, and allow participants the unfettered discretion to direct or redirect their own contributions to any investment alternative offered under the plan.[285] This was the case with Enron's 401(k) Plan, which did not impose any diversification restrictions on plan assets derived from employee elective deferral contributions.[286] Yet, despite their apparent ability to diversify a

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[281] H.R. 1000, § 104.

[282] *Id.*

[283] Press Release, Plans to Reintroduce Pension Security Act, *supra* note 41 ("The [House Bill] will give employees new freedom to sell company stock and diversify into other investment options.").

[284] ERISA § 407(b)(2), 29 U.S.C. § 1107(b)(2) (2000).

[285] *See* Olivia S. Mitchell, *New Trends in U.S. Pensions*, at 19, *at* http://www.ier.hit-u.ac.jp/jprc/soukai/Mitchell.pdf (July 26, 2002) ("Thus some 87% of employees with 401(k) plans could elect among investment choices for their own contributions."); PSCA, *Company Stock 2002*, *supra* note 8, at tbl.8 (showing that only 1.1% of respondent plans required that some portion of employee elective deferral contributions be invested in a company stock investment alternative, with that percentage solely attributable to plans with 5000 or more participants).

[286] *Hearings on the Enron Collapse*, *supra* note 6, at 104 (statement of Mike Rath, Enron Corporation, Benefits Manager) ("Participants are free to trade the investments they select in their 401(k) accounts on a daily basis, including Enron stock.").

reported 89% of their company stock holdings,[287] Enron participants chose not to do so. Immediate diversification rights would have had no impact on Enron 401(k) Plan participants, and there is no evidence that enacting immediate diversification rights for all participant-directed 401(k) plan participants will have any impact on plan asset diversification.

Second, with respect to the impact of the three-year diversification right, recent surveys and reports indicate that lifting diversification restrictions will have little impact on plan asset diversification. Not immune to criticism, it appears that a significant portion of 401(k) plans with company stock holdings have already removed employer contribution diversification restrictions or are in the process of amending their plans to remove such restrictions. While past studies indicated that over 85% of ERISA Section 404(c) plans placed some restriction on participants' ability to diversify employer contributions made in the form of company stock,[288] more recent studies suggest that 65% of these participants can now choose the investment alternatives for employer contributions.[289] Yet, despite this growing trend, 401(k) plan accounts' asset diversification shows no significant improvement. For example, a recent study by Hewitt found that only

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[287] Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, *supra* note 8, at 3 ("The company has estimated that 89% of this stock was purchased by employees and that the remainder represents the corporation's matching contributions to the plan. . . ." (citations omitted)).

[288] *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 5. International Society of Certified Employee Benefit Specialists members responding to a survey indicated that, of the 401(k) plans where employer contributions were made in the form of company stock, 27% reported that they restricted diversification rights throughout a participant's investment in the plan and 60% reported restriction until a participant attained a specified age and/or service requirement. *Id.*

[289] Mitchell, *supra* note 285, at 19 ("[Sixty-five percent of 401(k) plan participants] could elect investment options for employer contributions."); Munnell & Sunden, *supra* note 3, at 4 (citing a recent report by Fidelity showing "[thirty-six] percent of the plans (covering twenty-one percent of participants) had either removed restrictions on the sale of company stock in the last year or were considering such a change"); Press Release, Hewitt Associates, Hewitt Survey Reveals New Trends in Companies' 401(k) Plans, Employers Focus on Diversification, Understanding 401(k) Plan and Savings Quality, *at* http://www.hewitt.com/hewitt/resource/newsroom/pressrel/2002/04-22-02.htm (Apr. 22, 2002). A survey conducted by Hewitt of 280 respondent companies found that 62% of companies that made employer matching contributions in the form of company stock were either lifting, or considering lifting, restrictions on diversification. *Id.*

20% of 401(k) plan participants made any trades in their portfolio, despite market volatility and horrendous losses suffered by employees who were heavily invested in company stock.[290]

Participants' complacency with respect to both their own employee elective deferral contributions and employer contributions not subject to diversification restrictions may be due, in large part, to the tendency to leave investment allocations as previously directed.[291] Numerous studies have found that 401(k) plan participants fail to actively manage their account assets and instead leave plan assets in initial investment selections.[292] Given this tendency, participants are unlikely to make an affirmative election to diversify company stock holdings.[293] Although not present in any current pension reform bills, meaningful diversification rights would need to automatically trigger diversification of company stock holdings into a default investment alternative absent participant direction.

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[290] Press Release, Hewitt Associates, Hewitt Research Shows U.S. Employees Not Interacting with 401(k) Plan for Optimal Benefit, Study Examines Employees' 401(k) Savings and Investing Habits in Reaction to 2001 Events, *at* http://was4.hewitt.com/hewitt/resource/newsroom/pressrel/2002/07-08-02.htm (July 8, 2002) (finding in an examination of 800,000 employees and 500,000 active 401(k) participants found that in 2001 "only 19.5 percent of active 401(k) participants made any form of trade" and attributing the disconnect investment behavior, in part to inertia).

[291] Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149, 1185 (2001), *at* http://mitpress.mit.edu/journals/pdf/qjec_116_04_1149_0.pdf (analyzing the impact of automatic enrollment on 401(k) savings behavior and discussing the tendency to leave investment allocations as previously directed).

[292] *Id.*; *see also* Susan J. Stabile, *The Behavior of Defined Contribution Plan Participants*, 77 N.Y.U. L. REV. 71, 80 (2002) [hereinafter Stabile, *The Behavior of Defined Contribution Plan Participants*] (regarding "inertia," Stabile explains that employees' preference for the status quo coupled with the lack of certainty involved in directing account funds may lead to procrastination and, ultimately, inaction).

[293] *See Hearings on Enron and Beyond Enhancing Worker Retirement Security*, *supra* note 119 (testimony of Mr. Norman Stein, Professor of Law, University of Alabama School of Law) ("[G]iving employees a diversification option for employer stock is not enough. We have learned from behavioral economists that inertia is a powerful force in human behavior and that many employees are unlikely to take affirmative action to diversify because of inertia.").

2. *Overvaluing Pension Reform Proposals Aimed at Alerting 401(k)Plan Participants to the Dangers Associated with Company Stock Investment*

The House Bill contains ancillary pension reform measures that theoretically increase participants' ability to gain and assimilate information about the inherent dangers of 401(k) plan investment in company stock. Among the most glorified is the House Bill's investment advice proposal,[294] which has been promoted as "the most important pension protection of all."[295] Supporters expressed the view that Enron employees "might have been able to preserve their retirement savings if they'd had access to a qualified adviser who would have warned them in advance that they needed to diversify."[296]

The House Bill's investment advice proposal creates a prohibited transaction exemption under ERISA and the Code for investment advice provided by "fiduciary advisers."[297] Attempting to mitigate the costs

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[294] H.R. 1000, 108th Cong. § 105 (2003).

[295] Press Release, Committee on Education and the Workforce, NASDAQ Urges Senate to Consider Boehner Investment Advice Bill to Help Workers Protect their Retirement Savings (May 15, 2002), *at* http://edworkforce.house.gov/press/press107/invnasdaq51502.htm. Representative Boehner stated that "[i]n the wake of the Enron collapse, expanding worker access to quality investment advice is the most important pension protection of all." *Id.*

[296] Press Release, Plans to Reintroduce Pension Security Act, *supra* note 41; Fact Sheet, House Education & the Workforce Committee, Enron and Global Crossing Response Summary: Strengthening Retirement Security and Enhancing Corporate Responsibility (May 10, 2002), *at* http://edworkforce.house.gov/issues/107th/workforce/enron/JABOxleyKit1.htm ("Like most U.S. companies, Enron did not provide its workers with access to professional investment advice. Such advice would have alerted Enron workers to the need to diversify their accounts and enabled many to preserve their retirement savings.").

[297] H.R. 1000 § 105; *see also* STAFF OF J. COMM. ON TAXATION, 106TH CONG., TECHNICAL EXPLANATION OF THE REVENUE PROVISIONS OF H.R. 3762, THE "PENSION SECURITY ACT OF 2002" 14 (Comm. Print 2002), http://www.house.gov/jct/x-24-02.pdf [hereinafter STAFF OF J. COMM. ON TAXATION, TECHNICAL EXPLANATION] ("The provision adds a new category of prohibited transaction exemptions in connection with the provision of investment advice with respect to plan assets for a fee if (1) the investment of plan assets is subject to the direction of plan participants or beneficiaries, (2) the advice is provided to the plan or a participant or beneficiary by a fiduciary advisor in connection with a sale, acquisition or holding of a security or other property (an 'investment transaction') for purposes of investment of plan assets, and (3) certain other requirements are met.").

associated with hiring an independent investment adviser,[298] the House Bill allows interested parties (those that are already receiving fees or commissions for services rendered to the plan) to serve as fiduciary advisers, as long as they assume fiduciary liability for their advice and meet certain disclosure requirements aimed at notifying participants of potential conflicts of interest.[299] Plan fiduciaries, other than the fiduciary adviser, would not be responsible for monitoring the specific investment advice given by the fiduciary adviser to any particular participant; however, they would remain liable, under a fiduciary's duty of prudence, for the initial selection and monitoring of the fiduciary advisor.[300]

In addition to its investment advice proposal, the House Bill imposes additional disclosure and informational requirements on employers and plan administrators. Increasing ERISA's current requirement that 401(k) plan participants receive benefit statements on an annual basis,[301] the House Bill requires that certain individual account plans provide quarterly benefit statements outlining the importance of plan asset diversification, the current value of company stock investments, the inherent risks of excessive investment in company stock, and plan diversification restrictions on company stock investment.[302] The House Bill also contains an investment education notice requirement under which certain individual account plans would be required to provide participants with a notice upon commencing plan participation and on an annual basis thereafter.[303] The investment

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[298] *See* Press Release, House Education & the Workforce Committee, Senate Democrat Bill Will Leave Millions of Workers Without Investment Advice, Boehner Says, *at* http://edworkforce.house.gov/press/press107/invadv3602.htm (Mar. 6, 2002) (criticizing Senate investment advice proposal mandating independent investment advisers on the ground that it "would *significantly increase* the cost and administrative burden required of employers to provide these services").

[299] H.R. 1000 § 105 (including requirements that the fiduciary adviser inform participants of the relationship between the plan sponsor and the fiduciary adviser, any fees and commissions the adviser will be receiving, and any other disclosures required under applicable securities laws).

[300] *Id.*

[301] ERISA § 105(b), 29 U.S.C. § 1025(b) (2000) (requiring that plan administrators provide plan participants and beneficiaries with a summary of the benefits and investment alternatives offered under the plan and a benefit statement once every twelve-month period).

[302] H.R. 1000 § 101(a) (providing that requirement applies to individual account plans, other than stand-alone ESOPs).

[303] *Id.* § 101(b).

education notice would include an explanation of generally accepted investment principles, as well as the inherent risks of company stock investment.[304]

The blackout notification requirements[305] enacted under the Sarbanes-Oxley Act[306] are also meant to "offer [affected participants] ample opportunity to assess current investment decisions, and to adjust their exposure to loss if they wish to do so."[307] These requirements mandate that plan administrators generally provide a thirty-day advance written or electronic notice to affected participants of any impending blackout period,[308] with such notice including information about the unique risks associated with excessive investment in company stock and information meant to alert participants of the inherent risks of maintaining their account asset investment in company stock during a blackout period.[309]

Numerous factors indicate that these pension reform measures are not the talisman for promoting sufficient plan asset diversification and may

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[304] *Id.*

[305] *See* ERISA § 101(i)(7) (2003).

[306] *Id.* § 101(i) (as amended by Pub. L. No. 107-204, § 306(b)(1) (enacted on July 30, 2002)).

[307] Final Rule Relating to Notice of Blackout Periods to Participants and Beneficiaries, 68 Fed. Reg. 3716, 3723 (Jan. 24, 2003) (to be codified at 25 C.F.R. § 2520).

[308] *See* ERISA § 101(i)(7) (defining a blackout period as any period of three or more consecutive business days during which the ability of participants in an individual account plan to "direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited or restricted").

[309] *Id.* The notice is to include: the reason for the blackout; identification of the investments and other rights that are affected; the expected beginning date and length of the blackout period; and a statement that individuals should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts. *Id.*; *see also* Model Notice of Blackout Period, 29 C.F.R. § 2520.101-3(e)(4) (2003) ("For your long-term retirement security, you should give careful consideration to the importance of a well-balanced and diversified investment portfolio, taking into account all of your assets, income and investments. . . . You should be aware that there is a risk to holding substantial portions of your assets in the securities of any one company, as individual securities tend to have wider price swings, up and down, in short periods of time, than investments in diversified funds. Stocks that have wide price swings might have a large loss during the blackout period, and you would not be able to direct the sale of such stocks from your account during the blackout period.").

instead create a false sense of security for American workers.[310] The efficacy of each measure is based on the same ideological underpinnings supporting ERISA 404(c) fiduciary liability relief, which is that participants are capable of making independent investment decisions among employer-selected investment alternatives and of exercising control over their individual account plan assets. Recent studies by behavioral economists raise serious questions about plan participants' actual decision-making abilities given the context-dependence of these plans and other psychological influences.[311]

One aspect of context-dependence, referred to as the "framing effect," stems from employers' power to select investment alternatives and direct employer contributions to one or more investment alternatives. This power allows employers and other plan fiduciaries to retain significant influence over participant investment decisions, including asset allocations.[312] While there is some evidence to suggest that increasing the number of investment alternatives mitigates the framing effect,[313] the presence of a company stock investment alternative, particularly where employer contributions are made

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[310] *See* Fact Sheet, House Education & the Workforce Committee, Fact vs. Fiction: The Bipartisan Pension Security Act (H.R. 3762) (Feb. 19, 2002), *at* http://edworkforce.house.gov/issues/107th/workforce/enron/factsheet1.htm. Senator Edward Kennedy stated that: "the proposals by the Administration to reform our pension system simply create false hope. The President's plan would not have prevented the Enron workers from losing their retirement savings." *Id.*

[311] *See, e.g.*, Shlomo Benartzi & Richard H. Thaler, *Risk Aversion or Myopia? Choices in Repeated Gambles and Retirement Investments*, 45 MGMNT. SCI. 364 (1999); Shlomo Benartzi & Richard H. Thaler, *Naive Diversification Strategies in Defined Contribution Savings Plans*, 91 AM. ECON. REV. 79, 82 (2001) (finding employees' allocation decisions dependent on available fund alternatives).

[312] *See* Stabile, *Freedom to Choose Unwisely*, *supra* note 131, at 378; Stabile, *The Behavior of Defined Contribution Plan Participants*, *supra* note 292, at 88 ("The fact that the employer's choice of investment options has such an influence on participant choices, effectively framing or cabining the participant's control, complicates the causation analysis and should cause us to reconsider Congress's allocation of responsibility between participant and plan sponsor."); Sara Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2000*, ISSUES IN BRIEF, Nov. 2001, at 4, *at* http://www.ebri.org/pdfs/1101ib.pdf (finding that plan design influences participants' asset allocations).

[313] NELLIE LIANG & SCOTT WEISBENNER, INVESTOR BEHAVIOR AND THE PURCHASE OF COMPANY STOCK IN 401(K) PLANS—THE IMPORTANCE OF PLAN DESIGN 3 (Nat'l Bureau of Econ. Research Working Paper No. 9131, 2002), http://www.papers.nber.org/papers/w9131.pdf (finding that company stock purchases decline with an increase in investment offerings).

in the form of company stock, negates this mitigation and enhances the framing effect. Participants see the employer's choice to offer a company stock investment alternative and to direct employer contributions to that alternative as "implicit investment advice" with respect to the prudence of such an investment, which results in significant investment in company stock.[314]

In addition to "design" context-dependence, other psychological factors influence participants' ability to make independent investment decisions, including overconfidence in the employer and a misplaced sense of employee loyalty. Overconfidence in the employer is often based on the past performance of company stock in relation to other investment alternatives. Based on that past performance, participants project future gains to be derived from company stock investments and invest accordingly.[315] Experts agree that overconfidence in company stock is unwarranted with the rate of return on company stock no higher than the rate of return on a diversified portfolio and past gains being a poor predictor of a stock's future performance.[316]

Employee loyalty also promotes participant investment in company stock and is often based on real or perceived pressures applied by employers and their executives. As evidenced by the apparent communications from Enron executives to Enron 401(k) Plan participants,[317] employ-

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[314] Benartzi, *supra* note 251, at 1752 ("When the match is in cash, employees invest 18 percent of their own contributions to company stock; when the match is in company stock, employees invest more (29 percent) of their own contributions in company stock. It is possible that employees interpret stock matches as an endorsement or as implicit investment advice."); *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 2 (finding that, while the "aggregate percentage of 401(k) assets that are in company stock is equal to 19 percent," where company stock is offered "as either an employer match and/or an employee investment option, 32 percent of plan assets are in company stock if the plan sponsor does not offer a GIC (guaranteed investment contract, a stable-value investment) and 28 percent if it does")

[315] Benartzi, *supra* note 251, at 1762 ("[A]llocations to company stock are correlated with past returns but not with future returns, which is consistent with the excessive extrapolation hypothesis.").

[316] Mitchell & Utkus, *supra* note 4, at 31.

[317] *Hearings on the Enron Collapse*, *supra* note 6, at 182 (written statement of Thomas Padgett, *supra* note 13); *see also* Richard A. Oppel, Jr., *Despite Warning, Enron Chief Urged Buying Shares*, N.Y. TIMES, Jan. 19, 2002, at A1 (noting that CEO Kenneth Lay reportedly had an online chat with Enron employees indicating that Enron company stock continued to be a sound investment a week after he was directly notified about Enron's questionable accounting practices).

ers will continue to offer optimistic forecasts of corporate performance and the long-term profit potential of company stock investments, and such pronouncements will play on institutionally-fostered employee loyalty norms, which will in turn affect participant decision-making abilities.

Even if the effect of context-dependence and other psychological factors influencing participant investment decisions are discounted and the premise that participants can theoretically heed the warnings contained in the ancillary pension reform measures is accepted, however, the potential effectiveness of each of the aforementioned pension reform measures remains questionable. The House Bill's investment advice proposal contains numerous procedural and substantive problems. A procedural problem arises from the decision to legislate investment advice under ERISA and the Code. In her recent article, Professor Dana M. Muir indicates that regulating investment advisers through ERISA "raises a number of concerns because of the states' and the [Securities Exchange Commission's ("SEC")] existing authority over, and expertise with, investment advisers."[318] The House Bill's investment advice proposal defines "fiduciary adviser" to include certain banks or similar financial institutions and insurance companies qualified to do business under the laws of the state but not necessarily registered with either the state or the SEC.[319] Professor Muir indicates that the extension of the definition of adviser to individuals who are not registered with a state or the SEC introduces individuals into the process who have not been historically regulated and adds an additional layer of complication to the regulatory scheme.[320]

A substantive issue arises because the House Bill's investment advice proposal allows interested parties to provide investment advice to participants without seeking the services of an independent investment adviser.[321] This is a significant departure from ERISA's party-in-interest rules. As previously noted, ERISA's prohibited transaction rules currently preclude interested third party service providers from rendering independ-

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[318] Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMPL. & LAB. L. 1, 46 (2002).

[319] H.R. 1000, 108th Cong. § 105(g)(6)(A)(ii), (iii) (2003).

[320] Muir, *supra* note 318, at 48 ("The extension of the prohibited transaction exemption [of H.R. 2269] to individuals who are not registered with a state or the SEC as an investment adviser further complicate the regulatory scheme.").

[321] H.R. 1000 § 105; *see also* SunAmerica Opinion, *supra* note 176 (sanctioning interested third-party investment advise based on independent financial expert asset allocation recommendations).

ent investment advice on any investment alternative for which the provider may receive an additional fee as a result of the participants' investment decisions.[322]

The importance of appointing independent investment advisers can be traced back to ERISA's legislative and regulatory history, which repeatedly raised the concern of whether interested parties can effectively carry out their fiduciary responsibilities.[323] The appointment of interested investment advisers creates conflicts of interests, the types of conflicts that led to pre-ERISA abuses. Interested investment advisers may strongly identify with the employer's own vision of the company's future profitability and may find it difficult to formulate an independent perspective on the true value of company stock.[324] Interested investment advisers may also be influenced by some of the same psychological factors that influence participant investment decisions, such as a sense of loyalty or commitment to the company and its policies, and company efforts to promote company stock ownership and organizational pressure to buy and own company stock. Additionally, the appointment of interested investment advisers opens the door to conflicted advice from providers who have financial incentives to promote their own offerings. These conflicts cannot be resolved by requiring plan fiduciaries to prudently select and monitor investment advisers, by placing broadly defined limitations on the class of persons who can serve as investment advisers, or by implementing disclosure require-

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[322] *See* ERISA § 406(b)(1), 29 U.S.C. § 1106(b)(1) (2000) ("A fiduciary with respect to a plan shall not deal with the assets of the plan in his own interest or for his own account."); *id.* § 406(b)(3) ("A fiduciary with respect to a plan shall not receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.").

[323] 56 Fed. Reg. 10,724, 10,734 (Mar. 13, 1991) ("The Department believes the involvement of an independent fiduciary is a critical element in ensuring the meaningful exercise of independent control by participants with respect to investments in employer securities. In this regard, the proposal provides that the 'independent fiduciary' cannot be affiliated with any sponsor of the plan."); *Private Pension Plans: Hearings Before the Subcomm. on Fiscal Policy of the Joint Economic Comm.*, 89th Cong. *123 (1966) (statement of Willard Solenberger, Assistant Director of the Social Security Department of the International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW), AFL-CIO) ("This idea of an independent fiduciary with responsibility for the investments has been one of the principles that underly UAW plans.").

[324] *See* Moench v. Robertson, 62 F.3d 553, 563 (3d Cir. 1995) (conflict of interest allegations go to the issue of whether ERISA fiduciaries who hold directorships can make impartial decisions or whether impartial decision-making is impossible).

ments under which investment advisers disclose outstanding conflicts of interest.[325]

A second substantive issue exists since there is no empirical evidence that employers will embrace the House Bill's investment advice proposal and engage the services of fiduciary advisers. While the House Bill ostensibly limits employers' and other plan fiduciaries' liability for the consequences of investment advice provided by fiduciary advisers, the bill fails to sufficiently address co-fiduciary liability concerns arising from the ill-defined retained fiduciary duty to prudently select and to periodically monitor the activities of fiduciary advisers, as well as monitor fiduciary advisers' potential conflicts of interest and fee arrangements.[326]

To be effective, any voluntary investment advice measure must include co-fiduciary guidelines.[327] In her detailed analysis of the House Bill's investment advice proposal, Professor Muir proposes the adoption of "a nonexclusive safe harbor" that addresses the procedural, interested party, and co-fiduciary liability concerns.[328] Under her proposal, the nonexclusive safe harbor would apply where (1) a plan offers "at least two choices of investment advisory firms," with "at least one of the choices [qualifying] as an independent adviser," (2) "the plan fiduciary [possesses] a good faith belief based upon a reasonable investigation that every investment advisory firm providing services . . . is registered as an investment adviser with the SEC," and (3) "the plan fiduciary [undertakes] an annual review sufficient to maintain a good faith belief that each investment advisory firm . . . remains registered with the SEC."[329]

If the three requirements are met, plan fiduciaries, other than the investment adviser, would be exempt "from liability for ERISA's fiduciary selection and monitoring requirements, as well as from 404(c) noncompliance."[330] Absent a safe harbor, such as the one proposed by Professor Muir,

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[325] *See The Retirement Security Advice Act of 2001: Hearings on H.R. 2269: Hearing Before the Subcomm. on Educ. & Workforce*, 107th Cong. (2001) (statement of Jon W. Breyfogle, representing American Council of Life Insurers).

[326] H.R. 1000 § 105.

[327] *See* Muir, *supra* note 318, at 50 ("Unless employers can become comfortable that they are able, with reasonable efforts, to meet their fiduciary obligations in monitoring the provision of investment advice, they will almost certainly be unwilling to retain entities to provide that advice.").

[328] *Id.* at 51.

[329] *Id.*

[330] *Id.*

plan fiduciaries will likely refrain from voluntarily appointing interested party fiduciary advisers.[331]

A third substantive issue arises because there is no evidence that a significant portion of participants will utilize the fiduciary adviser's services, even where the cost of such services is not passed through to participants. In a recent survey conducted by Human Capital Advisory Services and Pensions and Investments magazine,[332] 81% of plan sponsors that offer investment advice to participants reported that less than 25% of participants actually take advantage of the service, even though, under the majority of plans, the participants were not charged for the investment advice services.[333]

The House Bill's quarterly benefit statement and investment education notice requirements do little more than reflect current practices by the vast majority of large publicly traded companies.[334] Further, the dissemination of a quarterly benefit statement is only mandated where an individual account plan does not otherwise electronically post (e.g., through the company's internet site) its informational requirements. An overwhelming majority of large publicly traded companies provide access to plan and

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[331] *See* Medill, *The Individual Responsibility Model of Retirement Plans Today*, *supra* note 175, at 81-85 (outlining proposals that entail "providing guidance to employers" regarding both "the duty to monitor" and "co-fiduciary liability for investment advisor conduct").

[332] *See Deloitte & Touche 401(k) Survey Sheds New Light on 401(k) Reform Debate*, *at* http://www.benefitslink.com/articles/washbull021118.1.shtml (last modified Oct. 10, 2003) (reporting on Deloitte & Touche's 2002 Annual 401(k) Benchmarking Survey, conducted by Human Capital Advisory Services and Pensions and Investments magazine and included in the Nov. 18, 2002 issue of Deloitte & Touche's Washington Bulletin).

[333] *Id.* ("It is not clear whether [either the House or Senate investment advice] proposals would make 401(k) plan sponsors more interested in offering investment advice to participants. The real barrier . . . may be a lack of employee interest. According to the Survey, a solid majority (81 percent) of sponsors offering investment advice report that less than 25 percent of participants actually take advantage of it. (This is particularly surprising in light of the fact that only 21 percent of those surveyed indicated that participants pay for this advice.)"); *see also* PSCA 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS, *supra* note 178, at 52 ("When investment advice is offered, usage by participants is greatest in plans with fewer than 50 participants (56.6%) and least in plans with over 5,000 participants (31.1%).").

[334] STAFF OF J. COMM. ON TAXATION, TECHNICAL EXPLANATION, *supra* note 297, at 16.

account information on their Internet sites.[335] With minor modifications to reflect the proposal's content requirements, these companies could avoid separate issuance of the quarterly benefit statement.

With respect to the blackout notification requirements enacted under the Sarbanes-Oxley Act, while blackout periods are commonly utilized by plan administrators to facilitate changes in investment alternatives or recordkeepers, and during times of corporate restructuring (mergers, acquisitions, spinoffs), in the life of any given plan, they are an infrequent occurrence. Based on its review of limited statistical reporting, the DOL estimates that only 25% of affected plans impose a blackout period during any given year, with plans sponsored by large, publicly traded companies, who are more likely to offer company stock as an investment alternative, implementing blackout periods as infrequently as once every three to four years.[336] Furthermore, while the Act's notice requirements formalize the types of information that must be provided to affected participants, ERISA Section 404(c) plan administrators have, in the past, routinely provided notice of impending blackout periods,[337] as evidenced by the series of email blackout notifications issued by Enron 401(k) Plan administrators prior to implementation of the October-November 2001

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[335] PSCA 45TH ANNUAL SURVEY OF PROFIT SHARING AND 401(K) PLANS, *supra* note 178, at 55. Of plans with 5000 or more participants, 79.9% provide for contribution changes, 89.4% provides for balance inquiries, and 88.8% provide for investment changes using the companies' internet site. *Id.*

[336] Interim Final Rule Relating to Notice of Blackout Periods to Participants and Beneficiaries, 67 Fed. Reg. 64,766, 64,771 (Oct. 21, 2002) ("The Department reviewed available literature in an effort to establish a reasonable estimate of the frequency of blackout periods that would trigger notice requirements. One small survey of administrators of very large plans indicated that their largest plans had undergone a blackout period at a rate of once each three to four years. A different survey indicated a lower frequency of blackout periods, at a rate in the area of about 7% of plans per year. No comprehensive statistics on this frequency are available. However, the Department is aware that the imposition of blackout periods is not rare. For this purpose, the Department has assumed that potentially affected plans will impose blackout periods on average once each 4 years.... The Department believes that the assumption that 25% of potentially affected plans will impose a blackout period in any given year results in a reasonable estimate of the number of plans that will actually be affected.").

[337] *Id.* at 64,769 ("While many plan administrators may currently provide disclosures similar to those required by the statute and interim final rule, this new requirement will ensure that appropriate information is provided in a consistent and timely manner.").

blackout period.[338] Participants' receipt of modified blackout notices every three to four years fails to adequately stress the dangers of excessive company stock holdings.

III. CONCLUSION & RECOMMENDATIONS

For an increasing number of American workers, 401(k) plans are becoming their primary source of employer-sponsored retirement benefits.[339] No longer relegated to the supplemental status that historically justified promotion of the employee ownership goal in traditional individual account plans, American workers can ill afford retirement plans that allow them to place all of their eggs in one basket and then leave them solely responsible for watching that basket.[340]

To ensure that 401(k) plan participants spend their golden years in secure retirement instead of working under the golden arches, Congress must enact pension reform that strikes a balance between protecting participants and not deterring employers from sponsoring or making contributions to 401(k) plans.[341] That appropriate balance does not, however, dictate rejecting overall limitations on 401(k) plan investment in company stock. These plans bear no resemblance to the supplemental individual account plans that originally warranted special treatment,[342] and there are important public policy and tax policy reasons for ensuring 401(k) plan participants' retirement security.[343]

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[338] *See Hearings on the Enron Collapse*, *supra* note 6, at 281 (Appendix H, Submitted for the Record, E-Mail from ID from Human Resources News, to All PGE Employees (Sept. 27, 2001), E-Mail from Enron Announcements to All Enron Employees (Oct. 16, 2001), E-Mail from Enron Announcements to All Enron Employees (Oct. 22, 2001), and E-Mail from Enron Announcements to All Enron Employees (Oct. 26, 2001)).

[339] *See supra* notes 34 & 117 (indicating the decline in defined benefit plan coverage and the dominant role of 401(k) plans).

[340] MARK TWAIN, PUDD'NHEAD WILSON 148 (1894) ("Put all your eggs in the one basket and—WATCH THAT BASKET.").

[341] *EBRI Special Report: Company Stock in 401(k) Plans*, *supra* note 8, at 3 ("[A]ny recommendations to modify current pension law would attempt to strike a balance between protecting employees and not deterring employers from offering employer matches to 401(k) plans.").

[342] *See supra* notes 63 & 64 (explaining the special purpose of supplemental individual account plans).

[343] *Pension Plan Overhaul in Wake of Enron Collapse: Hearings on H.R. 10: Before the Subcomm. on Employer-Employee Relations of Comm. on Educ. & Workforce*, 107th Cong. 33-37 (2002) (testimony of Erik Olson, Board Member

The Senate Finance Bill's "choice" proposal strikes an appropriate balance by increasing diversification without providing a disincentive to employers.[344] Under the choice proposal, employers can continue making employer matching contributions in the form of company stock or the employer can include company stock as an investment alternative for employee elective deferral contributions.[345] Additionally, the choice proposal generally applies to all individual account plans that provide for participant-directed investment, and, therefore, addresses hybrid KSOPs.[346] To reap the touted tax and other benefits, the likely effect of the choice proposal is that employers will prospectively limit 401(k) plan company stock holdings to employer contributions made in the form of company stock. The removal of a participant-directed company stock investment alternative will result in a greater degree of diversification over time, as evidenced by the fact that 89% of the Enron 401(k) Plan's company stock concentration was attributable to participant-directed investment in company stock.

The Senate Finance Bill's choice proposal also effectively limits the impact of the requirement to participant-directed individual account plans that serve as participants' primary source of employer-based retirement income. Under a safe harbor, employers that sponsor a defined benefit plan that provides certain levels of coverage and benefits are exempt from the "choice" restriction.[347] In other words, employers that sponsor traditional defined benefit plans as their primary retirement plans and adopt supple-

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AARP) ("There is a legitimate and substantial public policy interest in ensuring that the assets of ERISA-governed, trusteed, tax-qualified retirement plans are invested in a prudent, diversified manner, so as to minimize the risk that the tax advantages accorded to those assets will fail to achieve their intended purpose of providing additional economic security in retirement.").

[344] S. 1992, 107th Cong. § 102 (2002).

[345] *Id.*

[346] *See generally id.*

[347] *See id.* This restriction would apply to both publicly-traded and closely-held stock. However, the restriction would not apply if the employer also maintains a "qualified defined benefit plan," which is defined as a plan that covers at least 90% of the individuals that are covered by the defined contribution plan and provides an accrued benefit that is actuarially equivalent to at least 1.5% of the participant's final average pay times years of service. The rationale supporting the "qualified defined benefit plan" exception is that the presence of such a plan adequately secures retirement benefits to the employer's employee, and the defined contribution plan is relegated to its historical status as a supplemental retirement plan.

mental individual account plans will not be affected by the restriction. Thus, the safe harbor relegates the employee ownership goal to its historical status as a secondary goal of ERISA. Within that context, plan fiduciaries can continue to offer an unrestricted company stock investment alternative as long as it is a prudent investment offering.

Meaningful pension reform must also include measures requiring the appointment of an independent fiduciary as a cost of sponsoring an ERISA Section 404(c) plan with a company stock investment alternative. As originally envisioned under ERISA Section 404(c) revised proposed regulations,[348] an independent fiduciary who is not affiliated with the plan sponsor can help ensure that both the initial selection and retention of a company stock investment alternative is prudent, that company stock is removed as an investment alternative where found to be an imprudent investment, and that the employer and other plan fiduciaries are not exerting improper influence over plan participants' investment decisions.

Pension reform must also include measures mandating employer-facilitated individually-tailored investment advice as a condition of ERISA Section 404(c) fiduciary liability relief.[349] An independent fiduciary can militate against employer influences that inappropriately promote company stock investment, but cannot encourage prudent investment selection among other investment alternatives.

Transferring investment decisions and risks to participants who lack the financial acuity to make informed decisions is a recipe for disaster. At least by mandating employer-facilitated individually-tailored investment advice, participants will be given the opportunity to attain the necessary tools for making prudent investment decisions. Further, to ensure that the investment adviser is acting "solely in the interest of participants,"[350] that adviser must be independent and free from conflicts of interest. Employers must see the cost of providing independent, individually-tailored investment advice as the cost of ERISA Section 404(c) fiduciary liability relief, which when measured against potential fiduciary liability for billions of dollars in plan losses, is inconsequential.

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[348] Proposed Rulemaking for Participant Directed Individual Account Plans, 56 Fed. Reg. 10,724, 10,734 (Mar. 13, 1991).

[349] Medill, *The Individual Responsibility Model of Retirement Plans Today*, *supra* note 175, at 74.

[350] ERISA § 404(a)(1), 29 U.S.C. 1104(a)(1) (2000).