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401(k) Plans in the Wake of the Enron Debacle

Bradley P. Rothman

NOTE

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*Bradley P. Rothman** **

* For my parents, Dr. Stanley and Tara Rothman.

** I thank Professor Patricia Dilley for introducing me to this topic.

I. INTRODUCTION

With 21,000 employees and an annual revenue of 100 billion dollars, Enron Corp. (Enron)[1] ranked seventh on the Fortune 500 in 2001, ahead of both IBM and AT&T.[2] Within a year of achieving this milestone, Enron's stock fell seemingly overnight from its peak of over ninety dollars a share to approximately fifty cents a share.[3] As a result of this slide, many of Enron's employees incurred sharp losses in their retirement savings because their employer-sponsored 401(k) plans[4] had over sixty percent of the assets invested in Enron stock.[5]

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1. Enron was an energy trading company in the nation's largest deregulated market for electricity and natural gas. Rebecca Smith & John R. Emshwiller, *Running on Empty: Enron Faces Collapse as Credit, Stock Dive and Dynegy Bolts*, WALL ST. J., Nov. 29, 2001, at A1.

2. *Id.* At this time, Fortune Magazine dubbed Enron the most innovative company in the country. *Id.*

3. Robert O'Brien, *Dynegy and ChevronTexaco Slide Along With Plunge in Enron Stock*, WALL ST. J., Nov. 29, 2001, at C2. At one point, in August 2000, Enron's stock sold for more than ninety dollars a share. *Id.* In October 2001, Enron's stock began to decline rapidly after Enron reported a quarterly loss and allegations surfaced of wrongdoing by company executives. Smith & Emshwiller, *supra* note 1. Allegedly, Enron executives, including Enron's Chief Financial Officer, profited, at the expense of the company and its shareholders, from partnerships that moved assets on and off Enron's books. *Id.* On November 28, 2001, credit-rating agencies downgraded Enron's debt to junk status and Dynegy Inc., a rival of Enron, called off a planned merger with Enron. *Id.* Following these announcements, Enron's stock lost about eighty-five percent of its value as it dropped from approximately four dollars a share to sixty-one cents a share. O'Brien, *supra*. A few days later, Enron filed for bankruptcy, the largest bankruptcy filing in U.S. history. Rebecca Smith, *Enron Files for Chapter 11 Bankruptcy, Sues Dynegy*, WALL ST. J., Dec. 3, 2001, at A3.

4. Established pursuant to section 401(k) of the Internal Revenue Code, a 401(k) plan allows an employee to voluntarily elect "to make pretax contributions to his or her account with the plan. Most employers devise plans in which the employer matches the employee's contributions, commonly with a match rate of 50 percent, usually up to a ceiling such as five or six percent of compensation." JOHN H. LANGBEIN & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 50-51 (3d ed. 2000) [hereinafter PENSION LAW].

5. Ellen E. Schultz, *Enron Workers Face Losses on Pensions, Not Just 401(k)s*, WALL ST. J., Dec. 19, 2001, at C1. Moreover, Enron manipulated their traditional employee pension arrangements to make them dependent on fluctuations in Enron stock. *See id.* However, Enron employees with traditional pension arrangements were much better off after Enron's collapse than Enron employees with 401(k) plans. *See* Albert B. Crenshaw, *A 401(k) Post-Mortem; After Enron, Emphasis on Company Stock Draws Scrutiny*, WASH. POST, Dec. 16, 2001, at H01.

The Enron debacle illustrates[6] that 401(k) plans make ineffective retirement plans and, therefore, threaten the strong public interest of preserving the institution of retirement. Typically, retired employees combine income from employer-sponsored retirement plans, Social Security, and private savings accounts to create a retirement income stream that meets their retirement needs.[7] The expectation of receiving this income stream allows employees to retire from the workforce in a planned and orderly fashion.[8] Accordingly, employers rely on this expectation as a labor planning tool while society relies on it to create job opportunities for young workers.[9]

Absent an effective retirement plan, however, many employees lack the means to retire.[10] This is because employees often depend on using private employer-sponsored retirement plans to meet their retirement income needs.[11] In this situation, an employee's comfortable retirement hinges on the financial success of the employee's retirement plan. Commonly, 401(k) plans serve as primary retirement plans for employees.[12] For these employees, like many Enron employees,[13] a 401(k) plan may carry severe consequences.[14]

Although 401(k) plans are not consistently effective for retirement savings purposes, the use of a 401(k) plan as an employee's primary

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6. Enron represents merely an example of how 401(k) plans can jeopardize an employee's retirement savings. Other notable examples include Lucent Technologies, Inc. and Ikon Office Solutions, Inc. *See* Theo Francis & Ellen Schultz, *Enron Faces Suits by 401(k) Plan Participants*, WALL ST. J., Nov. 23, 2001, at C1; *see also* PENSION LAW, *supra* note 4, at 53-54 (describing how employees at Color Tile lost their retirement savings when Color Tile went bankrupt because Color Tile offered a 401(k) plan that was heavily invested in employer stock and employer real estate); Steven Greenhouse, *Enron's Many Strands: Retirement Money*, N.Y. TIMES, Feb. 2, 2002, at C1 (quoting Senator Jon Corzine mentioning the further examples of Sunbeam and Waste Management).

7. *See* PENSION LAW, *supra* note 4, at 23. In addition, an employee may need to rely on income from part-time employment during retirement to create a retirement income stream large enough to meet the employee's retirement income needs. *See id.*

8. *See* Patricia E. Dilley, *Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization*, 41 B.C. L. REV. 975, 1030 (2000).

9. *Id.* at 1032.

10. *See* Alicia H. Munnell, *The Economics of Private Pensions*, *in* PENSION LAW, *supra* note 4, at 34.

11. *See id.* at 34-35.

12. *See* Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 8-9 (2000).

13. *See, e.g.*, Francis & Schultz, *supra* note 6 (describing an Enron employee's 401(k) plan that fell in value from 470,000 dollars to 70,000 dollars after Enron's collapse); Schultz, *supra* note 5 (providing an account of an Enron employee whose pension savings, consisting of a 401(k) plan interrelated with a tradition pension arrangement, dropped from "about $200,000 to a couple of thousand dollars" after Enron's collapse).

14. *See supra* notes 6, 13.

retirement savings plan is becoming more prevalent.[15] Further, the low administrative and regulatory costs associated with a 401(k) plan provide employers with an incentive to sponsor such retirement savings plans.[16] Therefore, certain circumstances make 401(k) plans attractive alternatives to more reliable pension arrangements. As Enron revealed, however, the law presently provides employees with inadequate security for their 401(k) plans.[17]

Ironically, the Employee Retirement Income Security Act of 1974 (ERISA)[18] regulates 401(k) plans and most other employer-sponsored employee retirement plans.[19] Congress enacted ERISA to prevent employees from losing the retirement benefits employers promised them.[20] Congress intended to provide security for employee retirement plans, in large part, by equipping ERISA with demanding fiduciary rules to govern plan administration and investment.[21] Notwithstanding ERISA's fiduciary rules and underlying policy, 401(k) plans often place an employee's retirement at a substantial risk.

This Note describes the threat 401(k) plans pose to the institution of retirement. Part II will discuss the evolution of the modern concept of retirement along with the evolution of the private pension system. Part III will examine why ERISA does not provide adequate protection for an employee's retirement savings in a 401(k) plan and how 401(k) plans may impact federal retirement policy. Finally, Part IV will suggest judicial and statutory approaches that may help protect the institution of retirement from 401(k) plans.

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15. *See* Medill, *supra* note 12, at 8-9.

16. *See* PENSION LAW, *supra* note 4, at 52 (explaining that traditional pensions are often uneconomic for small employers). In addition, the employee match feature of 401(k) plans lets employees value employer contributions to their plans on a regular basis. *Id.* at 51. Further, 401(k) plans offer portability to an increasingly mobile workforce. *See id.* at 52. No law requires an employer to offer a retirement plan. Crenshaw, *supra* note 5, at H01. Fewer than half of the American workforce is covered by one. *Id.*

17. *See supra* notes 6,13; *see also supra* text accompanying notes 4-5.

18. Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974); *see generally* PENSION LAW, *supra* note 4, at 89-96.

19. *See* PENSION LAW, *supra* note 4, at 104-13.

20. *Id.* at 121.

21. *See id.* at 122.

II. THE EVOLUTION OF RETIREMENT AND PRIVATE PENSION PLANS

A. *From Humble Beginnings to the Retirement Security Dilemma*

Historically, most American workers remained in the labor force beyond their sixty-fifth birthday and did not expect to retire.[22] The relatively recent social phenomenon of retirement gained a foothold in American society in the early twentieth century.[23] Around this time, the government developed its first federal social welfare program to provide benefits to Civil War veterans, their widows, and their children.[24] Also around this time, private pension plans gradually emerged as a response to economic and social problems facing the elderly.[25]

By 1930, employers offering pension plans employed about ten percent of the nonagricultural labor force.[26] For the most part, employers financed employee pension plans themselves, without contribution from their employees.[27] Employers also regarded pension plans as gratuities and took careful precautions to ensure that they were not legally obligated to make pension payments.[28] Thus, although employers benefitted from pension plans by expressing to employees an intention to recognize their long and faithful service, employers reserved the right to alter or terminate their employees' pension plans at-will.[29]

The small number of employees covered by pension plans and the corporate practice of treating pension plans as gratuities kept employee retirements uncommon in the early twentieth century.[30] Yet, several innovations soon emerged, increasing the popularity of the notion of retirement.

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22. Dilley, *supra* note 8, at 1027.

23. PENSION LAW, *supra* note 4, at 4. Prior to this time, the elderly relied on the continuation of employment, frugality and savings, the support of family members, charity, or the poor house for support. William C. Greenough & Francis P. King, *Pension Plans and Public Policy, in* PENSION LAW, *supra* note 4, at 7.

24. Dilley, *supra* note 8, at 1027.

25. Greenough & King, *supra* note 23, at 7. By the late nineteenth century, the economic and social situation of the elderly became a large scale problem as a result of industrialization, "the dramatic impact of the railways, and the accelerating movement of America to urban centers." *Id.*

26. *Id.* at 8. Not all of the people employed by these employers "were eligible for plan membership." *Id.*

27. *Id.*

28. *Id.* at 9.

29. *Id.*

30. Employees retiring during this time generally provided for their own retirement through various types of informal, such as personal savings, or formal, such as privately purchased annuities, equity-based retirement savings plans. Dilley, *supra* note 8, at 1029. Less common were employees who retired relying on employer-provided pensions to meet their income needs. *Id.*

First, the enactment of Social Security in 1935 made retirement a possibility for the middle class.[31] In enacting Social Security, Congress primarily intended to protect people against poverty in old age.[32] However, at a time of sky-high unemployment, Congress also intended for Social Security to create new jobs.[33] Congress envisioned that Social Security would ease older workers from the workforce in a controlled manner, thus creating job opportunities for younger workers.[34]

Likewise, by the mid-1930s, employers realized the potential of retirement as a labor management tool.[35] Accordingly, employers developed private pension plans to control employee exits from the work force,[36] thereby enabling middle-class people to combine income from Social Security with income from private pension plans and retire without lifestyle compromises.

Pension plans also developed as a result of union pressure.[37] Initially, unions attempted to meet the old-age needs of members by creating their own old-age benefit programs.[38] As early as 1912, unions began offering members old-age benefits as a matter of right, rather than as a gratuity.[39] However, most union plans collapsed with the onset of the Great Depression.[40] Failing to maintain their own welfare plans, unions struggled for the next several decades to establish employer-provided pension plans across an array of industries.[41] During this time, unions advocated for financial soundness in pension plans while rejecting the gratuity theory as their underlying basis.[42]

Lastly, federal tax policy contributed to the private pension system's rapid growth.[43] During World War II, the federal tax structure underwent

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31. *Id.* at 1026.
32. *Id.* at 1031.
33. *Id.* at 1032. Congress enacted Social Security during the Great Depression, a time of fifty percent unemployment. *Id.*
34. *Id.*
35. *Id.*
36. *Id.* at 1030.
37. *See* Greenough & King, *supra* note 23, at 13-15.
38. *See id.* at 12.
39. *Id.*
40. *Id.* at 12-13.
41. *Id.* at 13-15.
42. *See id.* However, the gratuity theory of employee pension plans survived at least in part through the mid 1950s. PENSION LAW, *supra* note 4, at 127. The enactment of ERISA effectively did away with gratuity theory as a basis for employee pensions because ERISA severely limited an employer's ability to forfeit an employee's pension plan. *Id.* Today, deferred wage theory is the accepted description of an employer's pension obligations. *Id.* at 17. Deferred wage theory explains an employee's pension as "compensation earned during employment but paid during retirement." *Id.*
43. *See* PENSION LAW, *supra* note 4, at 15.

dramatic changes.[44] These changes caused taxes to pervade society like never before.[45] Consistent with the government's interest in using retirement to create jobs, the government exploited the new tax policy to encourage the private pension system's growth by allowing employers to instantly deduct contributions to pension plans and also by allowing the investment yield on plan assets to escape taxation "until the period of distribution, typically after [an] employee retires."[46] Thus, the government used tax policy as an incentive for both employers and employees to embrace pension plans. Indeed, tax policy is still a main factor perpetuating the private pension system today.[47]

Accordingly, by the middle of the twentieth century, the advent of Social Security converged with the development of the private pension system to create a societal expectation of retirement. Moreover, employees, employers, the federal government, and society at large shared an interest in preserving this expectation because it provided employees with motivation to work throughout the majority of their lives, and later encouraged them to stop working in old age.[48] However, a few days before Christmas in 1963, the closing of a Studebaker automobile plant and the accompanying termination of its pension plan covering 11,000 employees revealed that employees still could not always depend on their pension plans for retirement income.[49]

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44. *Id.* (showing that taxes increased dramatically for both employers and employees during and after World War II).

45. *Id.* During this time, tensions ran high between industry and labor because employers competing for workers were reluctant to increase wages. *Id.* To relieve tensions between industry and labor, the War Labor Board permitted the establishment of employee pension plans. *Id.* Thus, wage stabilization factored into the growth of the private pension system. *Id.*

46. *Id.*

47. *Id.*

48. *See* Dilley, *supra* note 8, at 1043-44.

49. Michael Allen, *The Studebaker Incident and Its Influence on the Private Pension Plan Reform Movement, in* PENSION LAW, *supra* note 4, at 68-71. After the closing, the plant's 11,000 employees were split into three groups. *Id.* at 69. Group one, consisting of 3,600 retirement-aged employees, received their pension benefits in full. *Id.* Group two, consisting of 4,000 employees between the ages of forty and fifty-nine with ten or more years of service at the plant, received approximately fifteen percent of their pension benefits. *Id.* Group three, a residual group consisting of 2,900 employees, "received nothing." *Id.* Soon after this, tragic stories of employees who lost their pension benefits emerged. *See, e.g.*, *id.* at 70-71 (describing Senate hearings in which a fifty-nine year old man testified that, after thirty-eight years of working for Studebaker, he was laid off, losing the pension benefits he had planned to rely on to retire).

B. *The Enactment of ERISA—The Retirement Security Solution*

The Studebaker plant closing[50] epitomized the problem of employees losing the pension benefits that they were relying on to retire.[51] Prior to the plant closing, government officials and private pension experts spent several years discussing this problem;[52] however, the plant closing provided the calamity necessary to propel pension reform to the forefront of the national policy debate.[53] Indeed, two years after the plant closing, a cabinet-level committee's report, reaffirming the strong public interest in private pension programs, found that Congress needed to make employee pension plans more reliable.[54] Yet, even with Studebaker as the "poster child" for pension reform, more than a decade of persistent policy advocacy passed before Congress finally enacted ERISA.[55]

Congress enacted ERISA for the purpose of protecting employee retirement benefits.[56] To achieve this end, ERISA contains fiduciary rules governing plan administration and investment.[57] Moreover, ERISA established the Pension Benefit Guaranty Corporation (PBGC) to guard an employee's retirement assets against an insolvent employer.[58] Thus, ERISA

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50. *See supra* note 49 and accompanying text. The Studebaker plant closing received intense media coverage. *See* Allen, *supra* note 49, at 71. This is probably because of Studebaker's standing as the oldest automobile manufacturer in the nation, coupled with the fact that a few days before Christmas thousands of employees, many losing their pension benefits, were laid off. *Id.*

51. *See id.* at 70.

52. James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA*, 49 BUFF. L. REV. 683, 732 (2001).

53. *See id.* at 735-38.

54. Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, *in* PENSION LAW, *supra* note 4, at 76-77. President Kennedy established the committee on March 28, 1962. *Id.* at 75. It was known as the Committee on Corporate Pension Funds and other Private Retirement and Welfare Programs. *Id.*

55. Wooten, *supra* note 52, at 739. On September 2, 1974, President Gerald Ford's signature enacted ERISA. *Id.*

56. *See* John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank, 510 U.S. 86, 96 n.5 (1993); *see also* Bellas v. CBS, Inc., 221 F.3d 517, 522 (3d Cir. 2000) ("The protection of retirement benefits reflects the underlying policy goals of ERISA.").

57. *See* PENSION LAW, *supra* note 4, at 122. Further, to protect retirement benefits, ERISA contains antiforfeiture rules, called vesting rules, that regulate the extent to which the forfeiture of pension benefits may occur. *Id.* at 121-22. Additionally, Congress supplied ERISA with reporting and disclosure requirements to make ERISA's substantive provisions enforceable. *Id.* at 122.

58. *See id.* at 900. For an individual retiring at the age of sixty-five, the Pension Benefit Guaranty Corporation (PBGC) provides insurance for vested accrued retirement benefits up to $35,000 per year. Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 611 (2000). Generally, few pension plan participants have benefits exceeding this amount. *Id.*

protects employees against threats to their retirement benefits including fiduciary breaches, poor investments, and employer insolvency.[59]

ERISA's protections, however, reflect the assumption that employer-sponsored retirement plans take the form of defined benefit plans, the predominant type of retirement plan in place at the time Congress passed ERISA.[60] Simply stated, defined benefit plans pool plan assets in an aggregate trust fund and promise employees a specified amount upon retirement.[61] With a defined benefit plan, the sponsoring employer bears the risk that the plan will attain the promised value.[62] Furthermore, insurance from the PBGC protects employees against employer insolvency.[63]

In contrast, defined contribution plans assign employees to an individual account.[64] An employee receives the entire account balance at retirement and usually determines, within limits,[65] the amount contributed to the account.[66] The success of a defined contribution plan largely depends on the investment decisions of the employee.[67] Since the account balance at retirement, instead of a predetermined amount, determines an employee's total retirement benefit, the employee, rather than the employer or the PBGC, bears the risk of accumulating insufficient retirement savings.[68]

Beyond assuming this risk, the employee in a defined contribution plan faces a further disadvantage in that ERISA affords retirement benefits in a defined contribution plan less protection than retirement benefits in a defined benefit plan.[69] This is because when Congress enacted ERISA, defined contribution plans were uncommon and were used primarily to supplement defined benefit plans.[70] The emerging trend, however, has been for employers to offer defined contribution plans as primary retirement

59. *See* Jefferson, *supra* note 58, at 611-12. Inadequate funding is another threat to an employee's retirement benefits against which ERISA protects. *Id.* at 612.

60. *See id.* at 613.

61. *Id.* at 610.

62. James Epstein, Note, *Protecting Pension Annuities When Insurance Companies Fail: The ERISA Fiduciary Standards*, 44 FLA. L. REV. 107, 107 n.1 (1992).

63. Jefferson, *supra* note 58, at 611-12.

64. Jefferson, *supra* note 58.

65. *See generally* Bruce Wolk, *The New Excise and Estate Taxes on Excess Retirement Plan Distributions and Accumulations*, 39 U. FLA. L. REV. 987, 989 (1987) (explaining that ERISA places limits on the amount of contributions allowed to retirement plans to prevent tax benefits from being used to subsidize excessively large retirement benefits).

66. Epstein, *supra* note 62, at 107 n.1.

67. Jefferson, *supra* note 58, at 628.

68. *Id.* at 611-12.

69. *See id.* at 614.

70. *Id.* at 613.

plans.[71] Specifically, the popularity of one type of defined contribution plan, the 401(k) plan, has skyrocketed.[72]

C. *The Emergence of 401(k) Plans—An Unanticipated Threat to Retirement Security*

Four years after Congress enacted ERISA, the Revenue Act of 1978[73] added section 401(k) to the Internal Revenue Code (IRC), thus creating what is now known as the 401(k) plan.[74] At the outset, Congress intended that 401(k) plans, similar to other defined contribution plans, would be used mainly for the purpose of supplemental retirement savings.[75]

As an incentive to save, a 401(k) plan allows an employee a tax deferral on a voluntarily elected portion of salary placed in an individual retirement account by an employer on behalf of the employee.[76] Typically, the employer matches a percentage of the employee's contributions to the 401(k) plan.[77] The match rate is commonly fifty percent up to a cap, such as five percent of the employee's total compensation for a given year.[78]

Structurally, 401(k) plans generally consist of a range of stock and bond portfolios from which an employee may choose to invest.[79] In addition, 401(k) plans frequently offer employer stock.[80] The employee makes investment decisions between the available alternatives to determine how plan contributions to the employee's account are allocated.[81] Thus, 401(k) plans are usually employee-directed and act like tax-deferred brokerage accounts. Importantly, as in the case of brokerage accounts and other forms

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71. *Id.*

72. Medill, *supra* note 12, at 6.

73. Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763 (1978) (codified as amended at I.R.C. § 401(k) (2002)).

74. PENSION LAW, *supra* note 4, at 51. The Revenue Act of 1978 took effect in 1980, six years after Congress enacted ERISA, making 401(k) plans available to the public. Medill, *supra* note 12, at 7. The roots of 401(k) plans can be traced back to 1972, "when the Treasury [Department] and [Internal Revenue] Service issued proposed income tax regulations concerning contributions to qualified retirement plans under salary reduction agreements." Richard F. Yates, *Social Security Tax Treatment of Cafeteria Plans*, 37 U. FLA. L. REV. 615, 622 (1985). This proposed legislation "set into motion a series of events that eventually" resulted in the creation of 401(k) plans. *Id.*

75. *See supra* text accompanying note 70.

76. *See* PENSION LAW, *supra* note 4, at 51. The income tax on a 401(k) plan contribution is deferred "until the time of withdrawal." *Id.*

77. *Id.* at 50.

78. *Id.*

79. *Id.* at 51. Usually, these portfolios are provided by "one or more of the mutual fund companies, banks, and insurance companies." *Id.*

80. Susan J. Stabile, *Pension Plan Investments in Employer Securities: More Is Not Always Better*, 15 YALE J. ON REG. 61, 66 (1998).

81. *See* Medill, *supra* note 12, at 11-12.

of defined contribution plans, retirement assets in 401(k) plans are not guaranteed by the employer to be at any particular level at the time an employee retires.[82]

In the decades since their inception, 401(k) plans have grown increasingly popular. Census bureau data indicates that in 1983, three percent of full-time private wage and salary workers participated in 401(k) plans.[83] Within ten years, that figure rose to forty-seven percent.[84] Moreover, in 1999, a study of 491 companies showed that forty-one percent of 401(k) plans were relied on by employees as a primary source of retirement income.[85] While 401(k) plans have become increasingly popular, the popularity of defined benefit plans appears to be waning.[86]

This shift is attributable to the preference employers and employees share for 401(k) plans.[87] Employers favor 401(k) plans because they are subject to fewer costs, administrative burdens, and cumbersome regulations than defined benefit plans.[88] Employees favor 401(k) plans because of the flexibility and employee involvement often associated with them.[89] Despite their popularity, 401(k) plans threaten the national interest in preserving the institution of retirement by providing inadequate security to employee retirement assets.

ERISA, for example, expressly limits the PBGC to apply to defined benefit plans, thereby leaving retirement benefits in defined contribution plans, such as 401(k) plans, uninsured.[90] Moreover, while ERISA's fiduciary rules provide strong protection to defined benefit plans, these rules provide little protection to 401(k) and other defined contribution plans.[91] Thus, 401(k) plans thwart the Congressional intent to use ERISA's strict fiduciary rules to protect employee retirement assets.

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82. *See* Epstein, *supra* note 62, at 107 n.1.

83. PENSION LAW, *supra* note 4, at 51.

84. *Id.*

85. Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. MICH. J.L. REFORM 469, 478 (2001). This figure is up from thirty-five percent in 1995. *Id.*

86. *See* John R. Keville, Note, *Retire at Your Own Risk: ERISA's Return on Investment?*, 68 ST. JOHN'S L. REV. 527, 534-35 (1994).

87. *See* Jefferson, *supra* note 58, at 614-15.

88. *Id.*

89. *Id.* at 615. For instance, 401(k) plans often have more liberal vesting schedules than traditional pension plans. *Id.* Some 401(k) plans, under certain circumstances, allow for account distributions prior to retirement. *See id.* Additionally, most 401(k) plans grant participants investment control over plan assets. *Id.*

90. *See* PENSION LAW, *supra* note 4, at 899.

91. *See infra* text accompanying notes 110-41.

III. THE STATUS QUO

A. *How ERISA's Fiduciary Rules Protect*

1. The ERISA Fiduciary Label

Congress designed ERISA "to remedy improprieties with respect to a benefits plan committed by" a fiduciary.[92] Accordingly, the significance of the fiduciary label cannot be understated. Without first identifying an individual as a fiduciary, little likelihood exists for bringing a successful ERISA action against that individual.[93]

For ERISA purposes, a fiduciary is anyone with discretionary authority or control over the management of a plan, the administration of a plan, or the disposition of a plan's assets.[94] Under this definition, fiduciary duties generally attach to plan administrators.[95] However, a plan may have more than one fiduciary.[96] Furthermore, no formal title is necessary to invoke fiduciary status.[97] Since, in the case of a fiduciary breach, liability only attaches to a fiduciary, designation as a fiduciary carries significant legal consequences. Therefore, employers commonly avoid fiduciary liability by not engaging in any activity, such as plan administration, that invokes fiduciary status.

Moreover, an employer invoking fiduciary status, by serving as a plan administrator, for example, still escapes fiduciary liability if, during the alleged breach, the employer acted as a plan settlor instead of as a plan fiduciary.[98] An employer functions as a plan settlor when the employer acts in a business capacity such as by adopting, implementing, amending, or terminating a plan.[99] Conversely, an employer serving in a business capacity

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92. Munoz v. Prudential Ins. Co. of Am., 633 F. Supp. 564, 570 (D. Colo. 1986).

93. PENSION LAW, *supra* note 4, at 653.

94. Employee Retirement Income Security Act (ERISA) § 3(21); 29 U.S.C. § 1002(21) (2000). Generally, attorneys, actuaries, accountants, and consultants are not considered fiduciaries under ERISA. Frank P. VanderPloeg, *Role-Playing Under ERISA: The Company as "Employer" and "Fiduciary,"* 9 DEPAUL BUS. L.J. 259, 299-300 (1997). Moreover, an individual performing "purely 'ministerial' functions for a benefit plan is not a fiduciary. Such ministerial functions include the application of rules determining eligibility for participation, calculation of services and benefits, and collection of contributions." Blatt v. Marshall & Lassman, 812 F.2d 810, 812 (2d Cir. 1987) (citations omitted).

95. VanderPloeg, *supra* note 94, at 264.

96. *See Blatt*, 812 F.2d at 812.

97. *Id.*

98. VanderPloeg, *supra* note 94, at 272-75.

99. *Id.* at 273-75. This is "provided that the benefits reduced or eliminated are not accrued or vested at the time, and that the [employer's action] does not otherwise violate ERISA or the express terms of the plan." *Id.* at 276.

may invoke fiduciary liability by functioning as a plan fiduciary, such as by exercising control over plan administration.[100] Thus, a determination of whether an employer acted in a business or fiduciary capacity, at the time of an alleged fiduciary breach, is necessary before fiduciary liability will attach to that employer.[101]

In *Varity Corp. v. Howe*,[102] for example, the Supreme Court found that an employer triggered fiduciary liability by intentionally communicating to employees false information about the future security of their plan benefits.[103] In that case, an employer attempted to encourage its employees to transfer their jobs to a subsidiary employer by intentionally misrepresenting information about the future security of their benefits.[104] The Court rejected the argument that the employer acted in a business capacity when it made the intentional misrepresentations to its employees.[105] In rejecting this argument, the Court reasoned that the employer functioned in a fiduciary capacity because the employer, by communicating information concerning plan benefits to its employees, acted as a plan administrator, impacting its employees' decisions about plan participation.[106]

Although, the employer in *Varity* also served as the plan's administrator,[107] fiduciary liability will likely attach to any employer that intentionally misrepresents information to employees regarding their benefits.[108] Thus, when an employer intentionally misrepresents information to employees concerning their benefits, the employer may not avoid fiduciary liability by claiming to have acted in a business capacity or as a plan settlor.[109]

100. *See, e.g.*, Varity Corp. v. Howe, 516 U.S. 489, 498-503 (1996).

101. *See, e.g.*, *id.*

102. 516 U.S. 489 (1996).

103. *Id.* at 503-05.

104. *Id.* at 493-94. The employer also made misrepresentations to the employees about the subsidiary's future business prospects and financial viability. *Id.* The Court found that the employer's actions were motivated by a desire to eliminate benefit plan costs. *Id.* at 493.

105. *Id.* at 505.

106. *Id.* at 502-03. Moreover, the Court reasoned that a reasonable employee under the circumstances could have thought that the employer was communicating both as an employer and as a plan administrator. *Id.* at 503.

107. As noted by VanderPloeg, the *Varity* court emphasized the fact that the employer also served as the plan administrator. VanderPloeg, *supra* note 94, at 298. Although this fact undoubtedly strengthened the employee's argument that the employer acted in a fiduciary capacity when making intentional misrepresentations to employees about their future benefits, this fact should not be determinative on the issue. *Id.* at 298-303.

108. *Id.* at 303.

109. *See id.*

2. ERISA's Fiduciary Rules

A plan fiduciary has several duties to employees who are plan participants.[110] First, pursuant to section 404(a) of ERISA, a fiduciary must act for the exclusive benefit of plan participants and for the sole purpose of "providing benefits to participants and their beneficiaries" and defraying expenses associated with plan administration.[111] Of course, however, an employer that avoids qualification as an ERISA fiduciary may make plan decisions serving its own interests.

Second, section 404(a) requires that a fiduciary act with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[112] This duty of care includes an employer's duty to prudently "select and monitor the activities of both co-fiduciaries to the plan, including any investment advisors, and non-fiduciary service providers."[113]

Finally, under section 404(a), a fiduciary must prudently diversify the investments in a plan to minimize the risk of an employee sustaining large losses.[114] Generally, prudent diversification entails using modern portfolio theory, a theory telling investors how to combine investments in their portfolios to provide the return on investment they seek with the least possible risk,[115] to guide investment decisions.[116] Thus, a fiduciary generally has a duty to use modern portfolio theory to diversify a plan's investments to minimize risk and maximize the probability of financial success.[117]

In addition to fiduciary liability, an employer is also subject, pursuant to section 405 of ERISA, to co-fiduciary liability.[118] Under certain

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110. This Note concentrates on the fiduciary duties found in sections 404(a) and 405 of ERISA. However, section 406 of ERISA also imposes significant duties on an ERISA fiduciary. *Id.* at 265. Specifically, section 406 of ERISA "bars a fiduciary from causing a plan to engage in what he knows, or should know, is a prohibited transaction with a party in interest, or a self-dealing, conflict, or kickback transaction." *Id.* The role, in Enron's collapse, of actions governed by section 406 would make an interesting topic for future research.

111. ERISA § 404(a)(1)(A); 29 U.S.C. § 1104(a)(1)(A) (2000).

112. ERISA § 404(a)(1)(B); 29 U.S.C. § 1104(a)(1)(B).

113. Medill, *supra* note 12, at 31.

114. ERISA § 404(a)(1)(C); 29 U.S.C. § 1104(a)(1)(C). Additionally, a fiduciary must act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with" ERISA's fiduciary responsibility and plan termination insurance provisions. ERISA § 404(a)(1)(D); 29 U.S.C. § 1104(a)(1)(D).

115. BURTON G. MALKIEL, A RANDOM WALK DOWN WALL STREET 235 (6th ed. 1996).

116. *See* Jefferson, *supra* note 58, at 628.

117. *See* Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, Inc., 173 F.3d 313, 317 (5th Cir. 1999) (finding that ERISA requires that a fiduciary abide by modern portfolio theory).

118. ERISA § 405(a); 29 U.S.C. § 1105(a).

circumstances, co-fiduciary liability makes one fiduciary liable for another fiduciary's breach of a fiduciary duty.[119] For instance, an employer, who breaches its fiduciary duty of care by failing to monitor a fiduciary plan investment advisor may assume liability for any subsequent fiduciary breach by that investment advisor.[120]

3. The Relationship Between ERISA's Fiduciary Rules and 401(k) Plans

Although ERISA contains stringent fiduciary rules, these rules often do not apply to 401(k) plans. For instance, in the case of a defined benefit plan, the amount invested in employer stock cannot exceed ten percent of the plan's total assets.[121] This requirement helps protect plan participants from concerns about self-dealing and diversification of plan assets.[122] This requirement does not apply, however, to 401(k) and other defined contribution plans.[123] In fact, plan permitting, employees may invest up to one hundred percent of their 401(k) assets in employer stock.[124] Moreover, section 404(c) of ERISA exempts employers from much of their duties of care and prudence as well as from co-fiduciary liability when investment decisions are employee directed, provided the section's safe harbor provisions are met.[125]

Specifically, section 404(c) provides that in the case of a pension plan consisting of individual employee accounts, where a plan participant exercises control over an account's assets, no fiduciary shall be liable "for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control."[126] Additionally, pursuant to section 404(c), the plan participant exercising control may not be deemed a plan

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119. ERISA section 405(a) states in relevant part that:

> [A] fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances: (1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach; (2) if, by his failure to comply with section 1104(a)(1) of this title in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or (3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

ERISA § 405(a); 29 U.S.C. § 1105(a).

120. *See* Medill, *supra* note 12, at 32.
121. Stabile, *supra* note 80, at 80.
122. *Id.* at 67.
123. *See id.* at 67-68.
124. *See id.* at 68.
125. *See* Medill, *supra* note 12, at 33.
126. ERISA § 404(c)(1)(B); 29 U.S.C. § 1104(c)(1)(B).

fiduciary.[127] Thus, compliance with section 404(c) absolves employers from fiduciary and co-fiduciary liability for the investment decisions of employees.[128]

To garner the protection of section 404(c) the employer must comply with the section's statutory requirements and Department of Labor (DOL) regulations.[129] The DOL regulations provide that before a participant is found to have independent control over plan assets, the plan must meet several conditions.

First, a broad range of investment alternatives must be available to the participant.[130] An employer, however, may satisfy this requirement by offering employees with 401(k) plans only three investment alternatives.[131] Although employer stock cannot be counted as one of these alternatives, employers may add employer stock as an additional alternative.[132] Second, the participant should have the opportunity to give investment instructions with an appropriate frequency considering the market volatility of the plan's investment alternatives.[133] Third, the participant must be able to minimize the risk of large losses by diversifying within and among the investment alternatives.[134] Lastly, the participant must receive sufficient information to make informed investment decisions.[135] Significantly, however, this condition does not require employers to provide employees with investment

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127. ERISA § 404(c)(1)(A); 29 U.S.C. § 1104(c)(1)(A).

128. *See* Medill, *supra* note 12, at 34.

129. Keith R. Pyle, Note, *Compliance Under ERISA Section 404(c) with Increasing Investment Alternatives and Account Accessibility*, 32 IND. L. REV. 1467, 1469-70 (1999).

130. Medill, *supra* note 12, at 34.

131. Pyle, *supra* note 129, at 1472. The investment alternatives must have the following characteristics:

> (1) each alternative must be diversified; (2) each alternative must have materially different risk and return characteristics; (3) the alternatives must, when taken together, allow the participant or beneficiary to achieve a portfolio with risk and return characteristics at any point within a range that would be considered appropriate for the participant or beneficiary; and (4) each alternative, when combined with investments from the other alternatives, must tend to minimize through diversification the overall risk to the participant's or beneficiary's portfolio.

Id.

132. Medill, *supra* note 85, at 524. Plans offering employer stock as an additional investment alternative are subject to special rules that are designed to ensure that investment decisions are made by the employee without undue influence from the employer. *Id.*

133. Medill, *supra* note 12, at 34-35.

134. *Id.* at 35.

135. *Id.; see also* Medill, *supra* note 85, at 525-26 (describing the information that plan participants are required to receive).

education or advice.[136] Moreover, substantial evidence shows that employer communications with employees are ineffective in aiding employee investment decisions.[137]

Since employers have great incentive to meet the statutory and regulatory requirements of section 404(c), this section tends to reach 401(k) plans with relative ease.[138] Once the requirements of section 404(c) are met, "plan fiduciaries will not be liable for any losses that are the direct result of the participants' exercise of control."[139] Thus, employees with 401(k) plans usually are not protected by certain fiduciary obligations such as the fiduciary obligation to prudently diversify plan assets.[140] Should an employee, despite section 404(c), establish the occurrence of a fiduciary breach, recovery of damages is unlikely.

4. Recovering Damages—Reaching for a Well's Bottom

An employee, having lost retirement savings from a 401(k) plan, fortunate enough to establish a fiduciary breach, is like a certain traveler, lost in the desert, searching for water. After surviving several obstacles before finding a well, the traveler sees, collected at the well's bottom, only a puddle of water. Unfortunately, the lost traveler cannot reach it. Like the lost traveler unable to reach the water, the employee is unlikely to ever reach a fiduciary's pockets to recover damages. This is because courts have tended to contradict ERISA's stated purpose of protecting the retirement assests of employees by establishing fiduciary standards and providing remedies for breaches of those standards.[141]

Section 502 of ERISA provides that a civil action may be brought by a plan participant "to obtain . . . appropriate equitable relief."[142] In *Mertens v. Hewitt Associates*,[143] the Supreme Court shut the door on a participant attempting to collect compensatory damages beyond equitable relief.[144]

136. *See* Medill, *supra* note 85, at 526. One explanation for this is that employers, out of liability concerns, tend to provide investment information that is too vague to be useful. *See* Jefferson, *supra* note 58, at 630-32.

137. *See* Jefferson, *supra* note 58, at 638 (explaining that communications are often ineffective because employees either do not understand or disregard them).

138. *See* Medill, *supra* note 12, at 34.

139. Nell Hennessy & Frank Daniele, *Participant-Directed Retirement Plans Under Section 404(c)*, *in* ERISA FIDUCIARY LAW 176 (Susan P. Serota ed., 1995).

140. *See* Medill, *supra* note 12, at 33.

141. *See* Varity Corp. v. Howe, 516 U.S. 489, 513 (1996) (explaining ERISA's basic purpose).

142. ERISA § 502(a)(3)(B); 29 U.S.C. § 1132(a)(3)(B) (2000).

143. 508 U.S. 248 (1993).

144. *See id.* at 257-58. This case is generally cited for the proposition that an employee attempting to recover damages as a result of a fiduciary breach is limited to seeking "appropriate equitable relief." *Id.*; *see also, e.g.*, Kerr v. Charles F. Vatterott & Co., 184 F.3d 938, 944 (8th

Thus, even in the face of appalling fiduciary behavior, courts have not been willing to grant anything other than equitable relief.[145]

Furthermore, courts have generally interpreted "appropriate equitable relief" in such a restrictive fashion as to preclude the recovery of restitution except under exceptional circumstances.[146] Accordingly, an employee, after establishing a fiduciary breach, usually cannot recover a monetary award as compensation for lost retirement assets.

Significantly, aside from recovering damages from a fiduciary in a civil suit, an employee with a defined benefit plan may recover lost retirement assets from the employer or the PBGC, whereas an employee with a 401(k) plan does not have these options.[147] Thus, by drastically limiting an employee's ability to recover monetary damages against a fiduciary in a civil suit, *Mertens* particularly devastated the security of retirement assets in 401(k) plans.[148] Absent security from ERISA, the retirement of many employees with 401(k) plans rests on the false assumption that making sound investment decisions with a 401(k) plan ensures that an employee will achieve sufficient retirement savings.

B. *Determinants of 401(k) Plan Success or Failure*

As primary retirement plans, 401(k) plans shift investment responsibility from employers to employees.[149] In the case of a defined benefit plan, responsibility over plan investment decisions resides with the employer, its financial officers, and its expert advisors.[150] Conversely, in the case of a 401(k) plan, responsibility over plan investment decisions resides with the individual employee.[151] This shift in responsibility continues to serve, in the case of 401(k) plans, as a justification for the loosening of ERISA's

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Cir. 1999). Interestingly, however, *Mertens* involved employees attempting to recover damages against a nonfiduciary. *Mertens*, 508 U.S. at 251.

145. *See, e.g.*, Harsch v. Eisenberg, 956 F.2d 651, 656-61 (7th Cir. 1992) (finding that former employees were entitled to nothing more than equitable relief where a fiduciary repeatedly responded with excessive hostility and resistance to their requests for distributions from their profit sharing plans).

146. *See, e.g.*, *id.* at 656 (defining "equitable" as "injunctive or declaratory relief"); *Kerr*, 184 F.3d at 944 (noting that for a plaintiff to recover restitution, the defendant must have received "ill gotten gains").

147. *See infra* notes 149-52 and accompanying text.

148. *See* Jefferson, *supra* note 58, at 626 (explaining that the Supreme Court's holding in *Mertens*, that "nonfiduciary service providers are immune from fiduciary liability," may cause more harm to employees with defined contribution plans than to employees with defined benefit plans because employees with defined contribution plans are not protected by employer liability and the PBGC).

149. PENSION LAW, *supra* note 4, at 53.

150. *Id.*

151. *Id.*

fiduciary rules and the shift in liability over retirement assets from the employer and the PBGC to the employee.[152]

With full responsibility for achieving a satisfactory retirement benefit residing with the employee, a 401(k) plan's success turns on several interrelated factors. The first is decisions made by an employee regarding plan contributions and investments.[153] Because, in the case of a 401(k) plan, an employee decides the extent to which contributions are made to the plan,[154] an employee bears the risk of not contributing enough money to accumulate a satisfactory amount of retirement assets.[155] This risk is heightened by the fact that "[m]any Americans have a false sense of confidence . . . concern[ing] their own retirement."[156]

Moreover, while fiduciaries are obligated to use modern portfolio theory when making retirement investment decisions, employees are not.[157] Although use of modern portfolio theory is advisable to reduce risk and to achieve a satisfactory retirement benefit, employees with 401(k) plans tend to risk accumulating insufficient assets for retirement by following unconventional approaches to 401(k) plan investing.[158] This result is not surprising given the complexity of modern portfolio theory and the general nature or absence of investment education materials provided to employees.[159]

A related factor that tends to impact the success of a 401(k) plan is the extent to which a 401(k) plan is invested in employer stock.[160] Generally, investment advisors agree that an investment portfolio should contain no more than five to fifteen percent of any single stock.[161] Yet, on average, employees in defined contribution plans invest thirty-three percent of their plan assets in employer stock when it is offered as an investment alternative.[162] This phenomenon is explained by employees being influenced by employers and underestimating the risks associated with investing in employer stock.[163]

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152. *See* Jefferson, *supra* note 58, at 616.

153. *See* Medill, *supra* note 12, at 11.

154. *See* PENSION LAW, *supra* note 4, at 50.

155. Medill, *supra* note 12, at 70.

156. *Id.* at 14.

157. *See supra* notes 115-17 and accompanying text.

158. *See* Medill, *supra* note 12, at 26.

159. *Id.* Fear of invoking fiduciary liability prevents employers from providing employees with anything more than general investment education materials. *See id.*

160. PENSION LAW, *supra* note 4, at 53.

161. Stabile, *supra* note 80, at 81-82.

162. *Id.*

163. *Id.* at 82-83. Employer influence may be informal, such as employers "letting it be known that they look kindly upon employees' investing in employer [stock]," or it may be formal, such as employers "making 401(k) matching contributions solely in the form of employer [stock]."

Overinvestment of 401(k) plan assets in employer stock may jeopardize an employee's ability to retire in several ways. For example, employees that overinvest their 401(k) plans in employer stock are not insulated against the loss in value of that investment.[164] Of course, a retirement plan's under-diversification poses problems whether the source of the under-diversification is employer stock or not.[165] However, employees overly invested in employer stock face problems larger than those associated with under-diversification. For instance, an employer's misfortunes could lead to an employee losing both a job and retirement assets.[166] Thus, by overinvesting 401(k) plan assets in employer stock, an employee adversely impacts the security of retirement assets.

While an employee may control investment decisions, including the extent to which a plan is invested in employer stock, the success of a 401(k) plan depends in part on factors outside of an employee's control, such as the stock market and economic conditions during an employee's employment.[167] For example, although use of modern portfolio theory protects an employee against the risk of market fluctuations over the course of a career, use of modern portfolio theory only minimizes investment losses during stock market declines.[168] Therefore, an employee, properly using modern portfolio theory to invest 401(k) plan assets, may still accumulate an insufficient amount of assets for retirement if a large part of an employee's career coincides with a period of unsatisfactory market performance.[169]

Similarly, another factor outside of an employee's control that determines the success of a 401(k) plan is the market and economic conditions at the time funds from a 401(k) plan are distributed.[170] Because the value of a 401(k) plan largely depends on the prevailing market and economic conditions,[171] unfavorable market and economic conditions around the time retirement funds are needed may negate the results reaped from following a disciplined 401(k) investment strategy.

Id. at 82. Another explanation for employee overinvestment in employer stock is the sense of loyalty some employees feel toward their employers. *Id.* at 82-83.

164. *See id.* at 78-79.

165. *See id.*

166. *Id.* at 79.

167. *See* Stephen F. Befort & Christopher J. Kopka, *The Sounds of Silence: The Libertarian Ethos of ERISA Preemption*, 52 FLA. L. REV. 1, 8 n.32 (2000).

168. *See* MALKIEL, *supra* note 115, at 239 (stating that "when the market gets clobbered just about all stocks go down").

169. *See generally id.* at 372-73 (explaining that between 1968 and 1979, U.S. common stocks returned an average annual rate of only 3.1 percent and created a "nouveau poor in the United States").

170. *See* Befort & Kopka, *supra* note 167, at 8 n.32.

171. *See* Medill, *supra* note 85, at 470.

For example, in October 1987, when the value of stocks fell by one-third,[172] equity-based 401(k) plans, notwithstanding modern portfolio theory, inevitably lost approximately one-third of their value. This dramatic drop in the value of 401(k) plans surely altered the ability of many employees to retire as planned. Accordingly, a 401(k) plan's success, to an extent, depends on the state of the market at the time an employee's retirement funds are distributed.

C. *The Impact of 401(k) Plans on Federal Retirement Policy*

ERISA has not yet adapted to the modern reality that employer-sponsored retirement plans are now predominantly 401(k) plans. As a result, history repeats itself as, again, employees are not able to rely on their employer-sponsored retirement plans to meet their retirement income needs. Therefore, many employees will be unable to retire due to an insufficient accumulation of retirement assets or the uncertain effect the stock market will have on their retirement savings.

Moreover, employers, without their employees having an expectation of retirement, will no longer be able to rely on retirement as a tool to manage the orderly exit of their employees from the workforce. Likewise, as people stay healthier and live longer, young workers may have trouble entering the workforce as few jobs become open to them. Thus, without judicial and legislative change, the continued proliferation of 401(k) plans as primary retirement savings vehicles will negatively impact the institution of retirement and the strong national interest in preserving it.

IV. LEARNING FROM ENRON: A MODEL FOR CHANGE

Much like the 1963 Studebaker plant closing,[173] the Enron debacle exposed flaws in the private pension system that threaten the national interest in preserving the institution of retirement. Specifically, Enron highlighted that the law, at present, provides inadequate security to retirement assets in 401(k) plans.

At Enron, company officials permitted employees to overinvest their 401(k) plans in employer stock.[174] Beyond merely permitting this unorthodox approach to retirement investing, company officials, through formal policy and informal advice, encouraged employees to engage in it.[175]

172. MALKIEL, *supra* note 115, at 195.

173. *See supra* notes 49-55 and accompanying text.

174. *See, e.g.*, Schultz, *supra* note 5, at C1.

175. *See* Daniel Altman, *Experts Say Diversify, But Many Plans Rely Heavily on Company Stock*, N.Y. TIMES, Jan. 20, 2002, at 26; Albert B. Crenshaw, *Retirees, Workers Assail Enron on 401(k) Freeze*, WASH. POST, Dec. 19, 2001, at E12 (hereinafter *401(k) Freeze*); Sue Kirchoff, *Pension Panic: Enron Debacle Pushes Congress Toward Tightening 401(k) Rules*, BOSTON

Moreover, as Enron's stock began to slide, company officials initiated a "lock down" of 401(k) plans that prevented employees from selling the ill-fated stock before it was too late.[176] As a result of these practices, hundreds of Enron employees lost most of their retirement assets.[177] In the end, these employees were left only with questionable claims against Enron.[178]

This tragedy, like the Studebaker plant closing, garnered the media attention necessary to push the cause of retirement security to center stage of the national policy debate.[179] While the Enron debacle seems to have produced the assumption that 401(k) plan reform is necessary, disagreement exists over the extent of pension reform that is appropriate.[180] Nonetheless, due to the strong national interest of protecting retirement,[181] any attempt at 401(k) plan reform should focus on achieving retirement security for working people.[182] Further, courtroom advocacy should work in conjunction with legislative action to accomplish this objective.

A. *Courtroom Advocacy for Retirement Security*

1. The ERISA Fiduciary Label Revisited

Although the large losses in retirement assets suffered by Enron employees resulted largely from Enron's actions,[183] employees will have a difficult time recouping their losses unless the fiduciary label attaches to

GLOBE, Jan. 18, 2002, at C1. Beyond providing employees informal encouragement, Enron officials motivated employees to invest their retirement assets in Enron stock through a company-wide 401(k) plan policy. *See* Crenshaw, *supra* note 5, at H01. The 401(k) plan policy at Enron provided a match in Enron stock to those employees that made contributions to their 401(k) plan. *Id.* Further, employees could not move the matched shares of Enron stock into other investments until the they turned age fifty. *See id.*

176. Ellen E. Schultz, *'Lockdowns' of 401(k) Plans Draw Scrutiny*, WALL ST. J., Jan. 16, 2002, at C1.

177. *See* Leigh Strope, *Congress Attempts to Prevent Another Enron*, ORLANDO SENTINEL, Mar. 22, 2002, at B1.

178. *See* Albert B. Crenshaw, *Bad Advice, but Actionable?*, WASH. POST, Feb. 28, 2002, at E10.

179. *See generally*, Strope, *supra* note 177, at B1 (summarizing the issues involved in the Congressional debate over 401(k) plan reform that resulted from the Enron debacle).

180. *See id.*

181. *See* Albert B. Crenshaw, *401(k) Debate: The Jackpot vs. the Sure Thing*, WASH. POST, Mar. 24, 2002, at H04 (quoting Senator Edward M. Kennedy as saying, "I don't think there is a more important priority for Congress than the retirement security of American workers").

182. *But cf. id.* (finding that some members of Congress want pension reform to focus on an employee's ability to attain wealth, rather than an employee's retirement security).

183. *See supra* notes 174-78 and accompanying text.

Enron.[184] Thus, the question of whether Enron invoked ERISA fiduciary status is a pivotal one.

Under *Varity*, an employer invokes ERISA fiduciary status by intentionally communicating false information to employees concerning their benefits.[185] While Enron encouraged employees to invest their 401(k) plans imprudently, employees may have difficulty proving that Enron's communications with them constituted intentional misrepresentations of benefits information.[186] However, courts should extend *Varity* to attach ERISA's fiduciary label to employers that encourage employees to follow an imprudent 401(k) plan investment strategy.[187]

Varity essentially found that an employer that functions as a de facto plan administrator and misrepresents information about a benefit plan's security should be held liable as an ERISA fiduciary.[188] *Varity*, however, involved a welfare benefit plan and not a 401(k) plan.[189] A 401(k) plan is different from a welfare benefit plan or a defined benefit plan because plan assets are not held together in a trust, but are held in separate accounts for each plan participant.[190]

In the case of a 401(k) plan, an employer, by encouraging an employee to engage in a particular investment strategy, directly exercises discretionary control over the way a 401(k) plan is managed. This is because employees tend to change the investment allocation of their 401(k) plans based on their employers' suggestions.[191] Thus, an employer's encouragement directly impacts the composition of a 401(k) plan.

In this sense, by providing unconventional investment advice, an employer commandeers an employee's 401(k) plan. By contrast, in a situation involving a welfare benefit plan, as in *Varity*, the link between an employer's non-fraudulent communications with employees and an employer's discretionary control over plan management is much more

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184. *See supra* notes 92-93 and accompanying text.

185. *Supra* note 108 and accompanying text.

186. *See* Crenshaw, *supra* note 178, at E10.

187. Importantly, the proposed rule involves a determination of the acceptability of the investment approach encouraged by the employer and not a hindsight determination of an employee's investment success. *See* Laborers Nat'l Pension Fund v. N. Trust Quantitative Advisors, Inc., 173 F.3d 313, 317 (5th Cir. 1999).

188. *See supra* notes 103-09 and accompanying text.

189. Varity Corp. v. Howe, 516 U.S. 489, 491-92 (1996).

190. *See supra* note 61-66 and accompanying text.

191. *See* Medill, *supra* note 12, at 25 (finding that "employees consistently indicate that they respond to investment allocation educational materials by changing their plan investment allocation mix"). Moreover, informal and formal encouragement from employers clearly impacts the investment decisions of employees. *See, e.g.*, Altman, *supra* note 175, at 26; *401(k) Freeze*, *supra* note 175, at E12.

tenuous.[192] Thus, in the case of a 401(k) plan, the fiduciary label should attach to an employer each time the employer communicates with employees about their 401(k) plans.

Arguments may be advanced that an approach such as this one will discourage needed 401(k) plan education. This argument, however, does not hold weight. The "education" Enron provided to its employees jeopardized its employees' retirement security while benefitting Enron.[193] In fact, little or nothing can be gained by allowing employers to provide employees with retirement investment advice that is generally regarded as dangerous.

Accordingly, this rule would encourage employers to take steps to ensure that they do not carelessly threaten an employee's retirement security or provide employees with investment advice that serves the company rather than the employee. Clearly, under the proposed rule, the fiduciary label would attach to Enron and provide Enron employees with grounds upon which to seek relief. Even with this rule, however, relief for Enron employees still may not be forthcoming because current law would likely preclude them from recouping their losses.

2. The Well's Bottom Revisited

Should Enron employees try to recover their lost retirement assets, ERISA, as it has been interpreted through *Mertens* and subsequent federal court cases, would likely block them from recovering their losses. This is because courts have tended to construe ERISA section 502, "Civil Enforcement," to mean that an employee may not recover a monetary award for losses that result from a fiduciary breach.[194] To arrive at this interpretation, courts have ignored ERISA's general purpose and narrowed the meaning of equitable relief beyond recognition.

Indeed, interpreting ERISA section 502 to prevent employees from recovering retirement assets, lost as a result of fiduciary breaches, seems contrary to ERISA's primary purpose of protecting employee retirement benefits through the imposition of tough fiduciary standards.[195] In enforcing ERISA's fiduciary standards, section 502 provides employees with the power to enjoin a fiduciary from engaging in a practice that violates ERISA

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192. Thus, in *Varity*, the employer needed to intentionally misrepresent false information to employees concerning their benefits to function as a fiduciary by acting in the capacity of a plan administrator. *Varity*, 516 U.S. at 502-04.

193. *See, e.g.*, Richard A. Oppel, Jr., *The Danger in a One-Basket Nest Egg Prompts a Call to Limit Stock*, N.Y. TIMES, Dec. 19, 2001, at C1 (stating that "[c]ompanies favor using their own stock in 401(k) plans in part because of the tax breaks").

194. *See supra* notes 141-45.

195. Jefferson, *supra* note 58, at 620.

and the power to seek "other appropriate equitable relief."[196] If "other appropriate equitable relief" should be interpreted, as courts have suggested, to essentially include only injunctions and other like remedies, then this provision would appear to be redundant. In light of ERISA's purpose, however, Congress likely intended that, pursuant to section 502, employees could recoup losses sustained as a result of a fiduciary breach and deter fiduciaries from engaging in activities that would threaten the security of their retirement.

Yet, courts have mostly refused to grant restitution to employees under section 502.[197] Nevertheless, restitution is a remedy in equity.[198] Restitution concerns "the recapture of a benefit conferred on the defendant by the plaintiff . . . [and] recoveries that are measured by the amount of a defendant's unjust enrichment."[199] Moreover, with restitution, the "defendant's benefit is often measured by the plaintiff's costs."[200] Perhaps, in denying employees restitution, courts are overlooking the benefits that employees confer on employers when using employer-sponsored retirement plans.

Typically, employers benefit from an employee's use of a retirement plan. In the case of 401(k) plans, these benefits are obvious. The 401(k) plans save money for employers that otherwise would use defined benefit plans because 401(k) plans are cheaper to administer and maintain.[201] Further, in the case of a 401(k) plan, employers incur less liability for plan performance than they would incur using a defined benefit plan.[202] Employers also receive special tax benefits for 401(k) plan investments in employer stock.[203] Moreover, in viewing pensions as deferred wages,[204] employers derive motivational benefits from offering 401(k) plans, as they would from offering salaries.

Thus, courts should consider ERISA's primary purpose and how employers benefit from employee participation in a retirement plan when considering the amount of restitution due an employee following a fiduciary breach. Inevitably, when a 401(k) plan is involved, the employer will have materially benefitted from the employee's participation. Courts should be made aware of this. Where employees have lost retirement assets as a result of a fiduciary breach, attorneys should advocate restitution to deter

196. ERISA § 502(a)(3), 29 U.S.C. § 1132(a)(3) (2000).

197. *See supra* note 146 and accompanying text.

198. *See* Mertens v. Hewitt Assocs., 508 U.S. 248, 256 (1993) (finding that restitution is an equitable remedy); *see also* Ream v. Frey, 107 F.3d 147, 153 n.5 (3d Cir. 1997).

199. LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 330 (6th ed. 1996).

200. *Id.* at 339.

201. *See supra* note 16 and accompanying text.

202. *See supra* notes 121-52 and accompanying text.

203. *See* Oppel, *supra* note 193, at C1.

204. *See supra* note 42.

fiduciaries from engaging in future breaches. Restitution should approximately equal the extent of an employer's unjust enrichment, possibly measured by the reasonable costs of the employee.

In all, courts should seek to resolve pension plan conflicts in ways consistent with ERISA's primary purpose. Persistent courtroom advocacy for judicial adherence to ERISA's primary purpose may be an effective way to enhance employee retirement security by making it easier to label an employer as a fiduciary and by permitting an employee to recover "equitable" damages when retirement assets are lost as a result of a fiduciary breach. Certain other issues relating to retirement security must be tackled in the legislature.

B. *A Legislative Approach to Retirement Security*

1. 401(k) Plan Insurance

Since, in the case of 401(k) plans, employees bear full responsibility for accumulating enough retirement assets to retire,[205] employees are protected by comparatively weak fiduciary rules,[206] and employees' retirement benefits are at least partly determined by factors outside of their control,[207] insurance is needed to protect the security of retirement assets in 401(k) plans. However, the PBGC does not provide insurance to employees with 401(k) plans.[208] Congress, at the time it enacted ERISA, likely did not extend the PBGC to insure defined contribution plans because at the time ERISA was enacted they were not used as primary retirement plans.[209] Now that 401(k) plans commonly are used as primary retirement plans,[210] Congress should amend ERISA to provide insurance to them.[211]

2. A Repeal of ERISA Section 404(c)

Beyond providing 401(k) plans with insurance, the legislature should repeal section 404(c) of ERISA. Fiduciary duties are too important in protecting retirement security to allow employees to go without their protection. In place of section 404(c), the legislature should require that employers providing employees with 401(k) plans ensure that employees abide by modern portfolio theory. For instance, an employer could offer a

205. *See supra* notes 149-51 and accompanying text.
206. *See supra* notes 92-140 and accompanying text.
207. *See supra* notes 167-72 and accompanying text.
208. *See supra* note 90 and accompanying text.
209. *See supra* note 70 and accompanying text.
210. *See supra* notes 83-86 and accompanying text.
211. *See generally* Jefferson, *supra* note 58, at 649-71, for an excellent and detailed discussion about insuring defined contribution plans.

401(k) plan that lets employees choose stock portfolios representing different market segments, and requires that employees invest a certain percentage of their retirement assets in each market segment.

Under this approach, an employee benefits from having both control over retirement assets and proper diversification through the application of modern portfolio theory. Also, provided employers offer and maintain acceptable 401(k) plans, they still will not have to fear incurring liability with respect to the investment performance of an employee's 401(k) plan. Importantly, this approach applies ERISA's fiduciary standards to protect the retirement security of employees with 401(k) plans.

3. A Ten Percent Limit on Employer Stock in 401(k) Plans

Finally, the legislature should amend ERISA to prohibit employers from allowing more than ten percent of the assets in a 401(k) plan to be invested in employer stock.[212] This protection has been in place for defined benefit plans since ERISA's inception.[213] Now that the 401(k) plan is replacing the defined benefit plan as the premier employer-sponsored retirement savings vehicle,[214] the 401(k) plan should also receive this protection.

As evidenced by the Enron debacle,[215] overinvestment in employer stock is a wide-scale problem that potentially may lead to catastrophic consequences for unfortunate employees. Thus, by placing a ten percent limit on the amount of assets a 401(k) plan may have in employer stock, Congress could help protect retirement assets in 401(k) plans and deal with a serious threat to the national interest of preserving retirement.

V. CONCLUSION

Enron revealed that 401(k) plans, as presently constituted, provide inadequate security to an employee's retirement assets. The problem of retirement assets receiving insufficient security is not new. In fact, Congress enacted ERISA because of retirement security concerns. Now, more than twenty-five years after the enactment of ERISA, the retirement plan landscape has changed. To comport with its original purposes, the legislature needs to amend ERISA to reflect these changes. Moreover, the cause of retirement security needs to be advocated in the courtroom.

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212. *See generally Collapse of Enron Corp.: Hearing Before the Senate Comm. on Governmental Affairs*, 107th Cong. (2002) (statement of John H. Langbein, Professor, Yale Law School) (declaring that the law should prevent 401(k) plans from being more than ten percent invested in employer stock).

213. *See supra* note 121 and accompanying text.

214. *See supra* notes 83-86 and accompanying text.

215. *See supra* notes 1-5 and accompanying text.

Some people may argue that new 401(k) plan rules will discourage employers from offering retirement plans. This effect is unlikely. Despite new 401(k) plan rules, federal tax policy will continue to make it advantageous for companies to offer retirement plans. Moreover, retirement plans will continue to provide employers with an effective labor management tool and a mechanism for attracting labor in the open market. While employers may opt to restore defined benefit plans in place of their 401(k) plans, this result will only serve to increase employee retirement security. Many employers, however, will likely continue with their 401(k) plans because new regulations are unlikely to be onerous, especially when compared with the benefits employers receive from 401(k) plans.

Further, some people will argue that new 401(k) plan rules will restrict the rights of an employee to "strike it rich."[216] However, "rich" is not the name of the retirement game. The tax benefits associated with retirement plans should not subsidize an employee's gambling of retirement assets in hopes of becoming rich. Rather, the national interest is in protecting retirement security. In the wake of the Enron debacle, this is the concern that should guide the pension reform movement.

216. *See* Crenshaw, *supra* note 181, at H04.