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It's Payback Time, or Is It?: An Argument to Apply Universal Heightened Standards to All Employee Stock-Based Individual Account Programs in the Post-Enron Era and Why Sarbanes-Oxley's Preventive Measures Do Not Adequately Protect Employee Investor Interests

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"It is estimated that Enron's collapse resulted in employee pension plan losses of up to $1 billion, [but] . . . [i]f my eight coworkers alone lost $2.8 million, that estimate is low."[1]

I. INTRODUCTION

The numbers are staggering. Employees have lost an unbelievable amount of money in the last three years alone by investing their livelihoods on what was once thought to be a safe bet—their companies. The likes of Enron, WorldCom, Adelphia, HealthSouth, and others wiped out their workers' stock-based savings plans upon revelations of accounting improprieties and other fraudulent activities. However, despite the flood of

1. LOREN FOX, ENRON: THE RISE AND FALL 290 (John Wiley & Sons 2003) [hereinafter ENRON: THE RISE AND FALL].

litigation surrounding these entities accused of securities fraud, restitution for many employees may not materialize given the current statutory framework and concurrent pending bankruptcy proceedings. Employee investors are hardest hit, suffering tremendous losses by way of vanished retirement funds and worthless stock compensation instead of reaping the promised huge rewards in return for their hard work and dedication to the corporation under fire. Yet their opportunities for recovery are restricted and often leave some plaintiffs without any legal recourse against those who have compromised their financial security. Furthermore, the recent Sarbanes-Oxley Act, a direct response to the wave of scandals, only widens the doors slightly for future victims of fraud by their own corporations and does little for current victims. The law has not made significant progress to prevent similar future harm, and employee shareholders will likely continue to suffer irrecoverable losses at the hands of corporate directors.

In reaction to the recent scandals, Congress enacted the Public Company Accounting Reform and Corporate Responsibility Act, also known as the Sarbanes-Oxley Act, as a response to and a system of avoiding such horrors in the future.[2] However, Sarbanes-Oxley mainly speaks to pure securities violations: its express purpose is to "protect *investors* by improving the accuracy and reliability of corporate disclosures *made pursuant to the securities laws*, and for other purposes."[3] Certainly employees along with public investors in corporate securities will benefit from the new requirements and improvements set forth in Sarbanes-Oxley, but the fact of the matter is that many categories of employee funds remain largely unprotected and thus may still face the same tragic losses once again. Ironically, while the Act imposes enhanced provisions to protect the public, it fails to adequately address the concerns of the *corporate employee* as a future retiree, not simply as an ordinary shareholder in the corporation, and subsequent legislative activity evidences the fact that Sarbanes-Oxley still left many concerns unanswered.[4]

2. *See, e.g.*, Thomas G. Bost, *The Sarbanes-Oxley Act of 2002: A Summary*, N.C.L.P.I. 2003 WL 1909734, at *1 (April 2003) (remarking that Sarbanes-Oxley was "[s]parked by the Enron and WorldCom debacles and other widely publicized corporate and accounting scandals" and that it "is intended to establish investor confidence by improving the quality of corporate disclosure and financial reporting, strengthen the independence of accounting firms, and increase the role and responsibility of corporate officers and directors in financial statements and corporate disclosures"); Jen Rogers, *Fastow and his Wife Plead Guilty: Ex-Enron CFO Agrees to Serve 10 Years, Cooperate with Authorities: Will Skilling and Lay Be Next?*, CNN/MONEY, Jan. 14, 2004, *available at* http://money.cnn.com/2004/01/14/news/companies/enron_fastows/index.htm?cnn=yes (last visited Mar. 1, 2005) (alluding to the Sarbanes-Oxley Act, stating "Enron's implosion was among the first of a string of corporate scandals that ultimately led Congress to pass new laws aimed at stricter oversight of corporate accounting" because "[t]housands of . . . employees lost their jobs and much of their life savings, and investors lost billions of dollars," from the company's failure).

3. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) [hereinafter Sarbanes-Oxley Act] (emphasis added).

4. *See* S. 1892, 108th Cong. (2003). The Senate has introduced a bill calling for mandatory disclosure under ERISA where savings plans invest more than fifty percent of plan assets in the employer's securities.

Many employers, including those under investigation, use a variety of stock-based programs, eligible individual account plans (EIAPs)[5], such as typical 401(k)[6] pension plans, and employee stock ownership plans (ESOPs)[7] to defer compensation and to theoretically help employees prepare for their retirements.[8] The two basic programs differ significantly in regards to the duties and responsibilities of administrators. Moreover, federal law deals with any potential violations thereof quite differently.[9] Some programs, such as ESOPs, straddle the definitions and thus the purviews of both the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1001 *et seq.*,[10] and the Securities Acts of 1933[11] and 1934.[12] Other account plans, such as traditional pensions aimed at guaranteeing a secure retirement for those who have spent their lives in a company's service, often also contain employer stock investments in individual accounts but remain exclusively within the ambit of ERISA. And still others, such as phantom stock and certain stock option plans are not even entitled to the protection of either ERISA or the securities laws. In this regard, the ESOP plaintiffs alleging fraudulent conduct under federal securities laws will likely obtain very different results from the other EIAP plaintiffs despite the fact that all the benefit plans in question essentially involved the same shares of employer stock simply because ERISA does not comparably address such losses. Moreover, the pure ERISA plaintiffs cannot expect the provisions of Sarbanes-Oxley to affect their chances of recovery, as that Act focuses on the *public* securities marketplace, which again only accounts for the ESOP participants.

This Comment will attempt to argue for universal, uniform, enhanced protections for all EIAP participants investing in employer stock. It will first describe the major methods of deferred compensation in EIAPs, namely "traditional" pension plans and employee stock ownership plans, exemplified and illustrated by several companies currently involved in multiple litigations regarding securities and ERISA violations.[13] Next, the statutes and bases for relief will be presented, focusing on the rights of recovery for employee investors in the various compensation and pension

5. *See infra* notes 22-23 and accompanying text.
6. *See infra* notes 24-35 and accompanying text.
7. *See infra* notes 38-56 and accompanying text.
8. *See, e.g.*, *In re* Enron Corp. Sec., Derivative, & "ERISA" Litig., 224 F. Supp. 2d 511 (S.D. Tex. 2003); *In re* Duke Energy ERISA Litig., 281 F. Supp. 2d 786, 793 (W.D.N.C. 2003); Vivien v. WorldCom, Inc., 2002 U.S. Dist. WL 31640557, at *3-4 (N.D. Cal. July 26, 2002).
9. *See* discussion *infra*.
10. ERISA regulates all aspects of employer-provided benefit programs, from health and life insurance to retirement and investment assistance.
11. 15 U.S.C. § 77a *et seq.* (2004).
12. 15 U.S.C. § 78a *et seq.* (2004).
13. *See infra* notes 21-61 and accompanying text.

programs in the pending litigations and beyond.[14] Prior statutory remedies under securities laws and ERISA have not provided comparable relief to each of the two main categories of plan participants, with the securities laws providing the more wide-reaching and accessible theories of recovery for qualifying programs. Moreover, defendants have argued, sometimes successfully, for the application of one set of statutory remedies to the exclusion of the other, where in all likelihood the law should expressly permit multiple bases for recovery, or at least not unnecessarily limit plaintiffs' options, in cases where employee investors fall victim to fraud at the hands of their own companies and their directors.

This Comment will next explain that while commentators have argued for the application of federal securities laws to certain employee investment plans such as ESOPs, such imposition would still only provide protection for a limited number of employee investors,[15] nevertheless frustrating the purpose of ERISA by excluding a significant percentage of employees from much-needed enhanced regulations and protections.[16] The common thread of employer securities utilized in EIAPs will form the basis of the argument for a more uniform, or at least equalized, system of relief and protection for all employees, specifically suggesting across-the-board imposition of provisions similar to the improved securities laws to safeguard against stock fraud *in addition to* a more expansive reading of ERISA as suggested in the *Great West*[17] dissent so as to promote the true spirit of employee benefit programs.

This Comment will further demonstrate that the provisions in the Sarbanes-Oxley Act of 2002, which supposedly set forth new guidelines to avoid future debacles, have presented only a starting point from which to work towards complete protection for all employee plan participants.[18] Sarbanes-Oxley predominantly speaks to securities fraud recovery, providing safeguards against bankrupt fiduciaries and requiring more comprehensive disclosures. But ERISA remains largely unaltered, leaving the majority of employer stock account holders with little improvement. Thus, the Act instead only meets the needs of employee investors half way, because while ESOP participants and others with standing under the Securities Acts have gained even more protection,[19] pure ERISA pension holders have not made any substantial remedial gains with the Act. Finally, the conclusion will suggest certain adjustments and predict the likely

14. *See infra* notes 62-182 and accompanying text.

15. *See, e.g.*, Matthew T. Bodie, *Aligning Incentives with Equity: Employee Stock Options and Rule 10b-5*, 88 IOWA L. REV. 539, 599 (2003) (stating that "employee stock options should be treated as securities, embedded with the protections against risk of fraud that other shareholders receive" and arguing for allowing private rights of action to employees under Rule 10b-5); Keir N. Dougall, Note, *Augmenting ERISA with Market Discipline: Transforming Pension Plan Interests into Securities*, 24 U. MICH. J.L. REFORM 709 (1991) (arguing that pension interests should fall within the ambit of the Securities Acts).

16. *See infra* notes 183-255 and accompanying text.

17. Great-West Life & Annuity Ins. Co. v. Knudsen, 534 U.S. 204 (2002).

18. *See infra* notes 256-317 and accompanying text.

19. *See generally* Sarbanes-Oxley Act; Bost, *supra* note 3.

outcome and effects of the existing legislation on employee investment plans and the financial landscape in general.[20] The question will remain, however, as to the extent to which the legislature and the courts are willing to afford *all* EIAP investors, regardless of whether opting for ESOP "investments" in the corporation or traditional pension plans deferring compensation until retirement from company service, the greater security measures needed to safeguard their valuable financial, labor, and emotional investments.

II. EMPLOYEES AS INVESTORS IN ELIGIBLE INDIVIDUAL ACCOUNT PLANS—PENSION PLANS, ESOPS, AND OTHER TYPICAL INVESTMENT VEHICLES

A. *In General—Definitions and Examples*

Section 1107[21] governs individual employee stock investment, or Eligible Individual Account Plans ("EIAPs"). An EIAP is defined as "an individual account plan which is a profit-sharing, stock bonus, thrift or savings plan; [or] an employee stock ownership plan."[22] EIAPs are distinguishable from other ERISA savings plans in that, by the terms of the trust agreement creating the plan, the trustee is allowed to invest a greater amount of trust assets in employer stock than ERISA normally allows.[23] In turn, EIAP investors fall into two main groups, traditional savings or pension program participants and Employee Stock Ownership Plan ("ESOP") participants, each with differing characteristics and rights.

1. "Traditional" Pension Plans

Pensions and other savings plans play an integral role in the modern employment landscape, as they serve vital needs for both employees and employers. Traditional pension plans, often described as "401(k)" plans,[24]

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20. *See infra* notes 318-43 and accompanying text.

21. 29 U.S.C. § 1107 (2004).

22. 29 U.S.C. § 1107(d)(3)(A)(i).

23. *See* Shelby U.S. Distribs., Inc. v. Commissioner, 71 T.C. 874, 882 (1979). Ordinarily, ERISA section 407(a) (codified as 29 U.S.C. 1107(a)) limits the permissible percentage of plan assets that a trustee may invest in employer securities. However, EIAPs, as defined in section 1107(d)(3)(A) are exempt from the percentage ceiling where the plan documents "explicitly provides for greater investment in such assets." *Shelby*, 71 T.C. at 882.

24. 26 U.S.C. § 401(k) (2004). Section 401(k)(2) defines a "qualified cash or deferral arrangement" as

> any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of subsection (a)—
>
> (A) under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash;

are in essence *income deferral* programs.[25] The main purpose and distinguishing factor from ESOPs and other EIAPs or deferred compensation plans is that traditional pensions ostensibly help employees prepare for retirement,[26] whereas ESOPs are characterized as investments. Retirement savings plans allow employees "to invest a portion of their salaries in mutual funds or in company stock . . . represent[ing] a tax-deferred plan for retirement."[27] Pensions generally fall into two main categories, defined benefit and defined contribution programs.[28] Defined benefit plans are less risky, providing fixed sums of money regardless of plan investment success.[29] On the other hand, defined-contribution plans, specified in 29 U.S.C. § 1002(34),[30] feature investment characteristics, as the participant in

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> (B) under which amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election—
> (i) may not be distributable to participants or other beneficiaries earlier than—
> (I) severance from employment, death, or disability,
> (II) an event described in paragraph (10),
> (III) in the case of a profit-sharing or stock bonus plan, the attainment of age 59 1/2 , or
> (IV) in the case of contributions to a profit-sharing or stock bonus plan to which section 402(e)(3) applies, upon hardship of the employee, and
> (ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years;
> (C) which provides that an employee's right to his accrued benefit derived from employer contributions made to the trust pursuant to his election is nonforfeitable, and
> (D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410(a)(1) (determined without regard to subparagraph (B)(i) thereof).

Id.

25. *See, e.g.*, Dougall, *supra* note 15, at 715 ("Pension plans are financial arrangements under which employees can defer present income in favor of retirement benefits."); Leslie L. Wellman & Shari J. Clark, *An Overview of Pension Benefit and Fiduciary Litigation Under ERISA*, 26 WILLAMETTE L. REV. 665, 667-668 (1990) (defining an "employee pension benefit plan" as "any plan, fund or program that: 1) 'provides retirement income to employees; or 2) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond'").

26. *See generally Hearings on S. 3598 [ERISA] before the Subcommittee on Labor of the Senate Committee on Labor & Public Welfare*, 92d Cong., 2d Sess. 231 (1972) (statement of SEC Chairman Manuel Cohen) ("Realistically, the employee is simply putting into a fund for his future use that which he would otherwise get in his paycheck."); Sean S. Hogle, Note, *The Employee as Investor: The Case for Universal Application of the Federal Securities Laws to Employee Stock Ownership Plans*, 34 WM. & MARY L. REV. 189, at 213-14 (1992); Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1111 (1988) (defining a pension plan as a "program of savings during the worker's period of employment, followed by distribution to the worker and his spouse during their retirement").

27. *See* ENRON: THE RISE AND FALL, *supra* note 1, at 289 (describing the Enron retirement plan).

28. *See* 29 U.S.C. § 1002(34)-(35) (2004).

29. *See generally* 29 U.S.C. § 1002(35); SEC Release No. 33-6188, 45 Fed. Reg. 8960, 8963 (Feb. 11, 1980). The SEC Release stipulates that defined-benefit plans specify a particular amount of money to be paid in installments to retired employees as long as the company is solvent and the Plan still operates, and requires that sponsoring employers contribute to the plan to compensate for any discrepancies between plan "investment results" and actual "expectations." *Id.* Moreover, defined-benefit plans are safeguarded further by the Pension benefit Guaranty Corporation ("PBGC") which would compensate employees even where their former employer went insolvent. *See* 29 U.S.C. § 1322 (2004).

30. 29 U.S.C. § 1002(34) defines a defined-contribution plan as one "which provides for an

essence shares in the plan's gains or losses.[31] Defined contribution plans may be voluntary or mandatory, and contributory or non-contributory.[32]

Many companies use voluntary defined-contribution plans, and of those entities, many companies, like Enron, "encouraged employees to invest the[] funds in [employer] stock, and . . . [the company] matched employee contributions with [more employer] stock."[33] Unfortunately, pension programs leveraged with employer stock generally will not withstand a corporate crisis,[34] and certainly not when coupled with a scheduled "lockdown" of assets, which occur from time to time in order to change plan administrators or conduct other ministerial matters.[35] But in the end, a "traditional" plan still falls within the ambit of EIAPs and are thus exempt from the traditional protections of ERISA where the plan invests in employer stock.[36]

2. ESOPs

Section 1107 also defines an Employee Stock Ownership Plan ("ESOP") 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 section 401 of Title 26, *and which is designed to invest primarily in qualifying employer securities*, and
>
> (B) which meets such other requirements as the Secretary of the Treasury may prescribe by regulation.[37]

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individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account." *Id.*

31. *See* SEC Release No. 33-6188, at 8963 ("[D]efined contribution plans maintain individual accounts for all participating employees . . . [which] reflect each participant's share in the underlying trust assets and are adjusted annually to take into account plan contributions, earnings, and forfeitures.").

32. *See* Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979).

33. *Id.*

34. *See id.*

35. *See* Part V-E *infra* for discussion of the effect of "lockdowns."

36. *See* Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1094 (9th Cir. 2004) (discussing the different types of plans within the EIAP definition and distinguishing other ERISA plans).

37. 29 U.S.C. § 1107(d)(6) (2004) (emphasis added). *See* Penn. Fed'n, Bhd. of Maint. of Way Employees v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan, No. 02-9049, 2004 U.S. Dist. LEXIS 1987, at *3 (E.D. Pa. Feb. 4, 2004) (explaining EIAPs in general and in relation to the specific plan in that case). The Internal Revenue Code of 1986, section 4975(e)(7) alternatively classifies an ESOP as a defined contribution program "designed to invest primarily in qualifying employer securities." I.R.C. § 4975(e)(7)(A) & 29 U.S.C. § 1107(d)(6).

An ESOP basically provides a "tax-qualified, employee benefit plan designed to enable employees to acquire stock ownership interests in their employers."[38] An ESOP thus basically constitutes shareholding in the employee's company, made available to those otherwise unable to afford such investment.[39] ESOPs therefore differ from regular pension plans because they specifically promote employee *investment* in the employer's securities instead of mere deferral of compensation until retirement.[40] An ESOP does not necessarily provide a secure retirement fund but rather allows employees to become a part of the ownership of the company.[41] Congress specifically intended to encourage employees to take part in their corporations by owning employer stock.[42] It is in fact unclear why Congress decided that ERISA should govern ESOPs, [43] as aspects of such plans mirror investments more closely than retirement funds.[44]

But ESOPs, as an EIAP,[45] indeed still fall within the purview of ERISA and therefore differ from other employer stock ownership interests such as traditional stock options[46] and so-called "phantom stock" compensation,[47] which are not governed by ERISA.[48] In this regard, ESOPs still constitute areas of federal regulation and concern, especially because the programs resemble traditional deferred compensation plans, albeit including an extra

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38. Hogle, *supra* note 26, at 208 (arguing that ESOPs should be regulated and controlled by the 1933 and 1934 Securities Acts because of the stock and investment characteristics of the typical ESOP); *see* Hunter C. Blum, Comment, *ESOP's Fables: Leveraged ESOPs and Their Effect on Managerial Slack, Employee Risk, and Motivation in the Public Corporation*, 31 U. RICH. L. REV. 1539, 1542-43 (1997). The author states that "[p]roperly understood, an ESOP is simply a vehicle though which an employer sells stock to employees." *Id.* at 214.

39. *See* Blum, *supra* note 38, at 1542-44 (describing the legal history of the ESOP concept); Hogle, *supra* note 26, at 213-14 (describing an ESOP as "simply a tax-preferred means by which companies sell stock to employees in order to raise capital" and disapproving the tax code reference to an ESOP as a "pension plan").

40. *See* Blum, *supra* note 38, at 1543 (defining an ESOP as "deferred compensation" but with its "primary objective to provide stock ownership interests to its employees" due to its nature "as a *stock bonus plan* designed to *invest* primarily in employer stock") (emphasis added); Hogle, *supra* note 26, at 210-12.

41. *See* Hogle, *supra* note 26, at 211-12 (explaining that the "utility of an ESOP in providing for retirement is very limited" and that Congress did not intend to "provide a new, unnecessary, and inadequate source of employee savings" in promoting ESOPs through tax breaks, instead merely attempting to "broaden the base of capital ownership"); *see also* Blum, *supra* note 38, at 1549 (explaining that ESOPs essentially amount to a trade of the privilege of employer stock ownership for employee risk by lesser income and other benefits).

42. *See* S. REP. NO. 94-36, at 56 (1975); Kuper v. Iovenko, 66 F.3d 1447, 1459 (6th Cir. 1995).

43. *See* Hogle, *supra* note 26, at 212 & n.131 (citing *Employee Ownership on Hostile Takeovers: Hearings on S.1323 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 4 (1987) (statement of former Sen. Long)). Many commentators cite the standing of sponsoring Senator Long as Finance Committee Chair as the reason for the seemingly counterintuitive categorization of the provision within the tax code. *Id.*

44. Congress promulgated ERISA to ensure "fairer and more effective [pension plans] in providing retirement income for employees . . . ." H.R. REP. NO. 93-807, at 1 (1974).

45. 29 U.S.C. § 1107.

46. Bodie, *supra* note 15, at 549-50.

47. *Id.*

48. *Id.* at 549-50 (differentiating between the various stock ownership interests and distinguishing between the ERISA-regulated ESOPs and 401(k) plans as opposed to stock options or "stock bought on the open market").

element of risk. And Congress has certainly allowed ESOP administrators and other fiduciaries more room to maneuver, eliminating the duty to diversify plan investments imposed on traditional pension fiduciaries as well as the ban on self-dealings.[49] "[A]n ESOP fiduciary is often in a unique position of being required to administer an ESOP plan in such a fashion as to comply with the strict standards of fiduciary responsibility imposed by ERISA and yet satisfy the demands of Congressional policies affording ESOPs favorable treatment."[50] Thus, the regulation of ESOPs first serves to encourage employee investment in employer securities.[51] But the sticking-point appears, however, where the lines between the profit-sharing interests of employee as investor blur with the secure deferred compensation concerns of employee as future retiree. Thus, ESOPs must also work to protect investors like pension plan participants, and, therefore, the ERISA fiduciary duty to diversify likely still applies in a limited sense.[52]

Because ESOPs are subject to two competing policies, courts must adequately account for each concern in determining fiduciary duty in cases alleging improper fiduciary conduct and decision-making. Accordingly, courts have narrowly construed the exception to the general exemption for ESOP fiduciaries from the duty to diversify, finding a breach of fiduciary duty only where continuing to invest in employer stock clearly constituted an abuse of discretion.[53] Armed with the presumption of prudence, therefore, ESOP fiduciaries have a fairly formidable shield to liability for

49. *See In re* Duke Energy ERISA Litig., 281 F. Supp. 2d 786, 793 (W.D.N.C. 2003) (citing Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995) to illustrate Congress's intent to promote ESOPs and employee stock ownership by softening the conventional fiduciary requirements of ERISA).

50. *Duke Energy*, 281 F. Supp. 2d at 793.

51. *See Kuper*, 66 F.3d at 1459; Stein v. Smith, 270 F. Supp. 2d 157, 172 (D. Mass 2003). The court in *Stein* stated that

> [b]ecause the very purpose of an ESOP is to promote employee stock ownership, holding ESOP fiduciaries to the same duty as fiduciaries of other kinds of pension plans to diversify investments in order to reduce the risk of large losses would "risk transforming ESOP's into ordinary pension plans, thus frustrating [Congressional intent] . . . and contravening the intent of the parties."

Stein, 270 F. Supp. 2d at 172.

52. *See id.* (holding that *Kuper* and *Moench v. Robertson*, 62 F.3d 553, 571 (3d Cir. 1995), both consider the protection of employee investors in determining the appropriate application of the duty to diversify).

53. *See Duke Energy*, 281 F. Supp. 2d at 794 (following *Moench*, 62 F.3d at 571, and holding that ESOP fiduciaries are entitled to presumption that their "decision to remain invested in employer stock is a reasonable one"); Wright v. Or. Metallurgical Corp., 222 F. Supp. 2d 1224, 1233-34 (D. Or. 2002) (maintaining that breach of fiduciary duty in the ESOP context is merely a "narrow exception to the general rule" and that only an "unusual circumstanc[e]" such as "impending collapse" would warrant disregarding the statutory exception in favor of imposing the duty to diversify); *see also* Hill v. BellSouth Corp., 313 F. Supp. 2d 1361, 1367 (N.D. Ga. 2004) (discussing the defendant corporation's argument that the presumption of prudence should apply despite the fact that the circuit had yet to recognize the presumption).

breach of fiduciary duty, only facing sanctions where engaging in *clearly* egregious conduct.[54] Moreover, as illustrated in *Duke Energy ERISA Litigation*, courts apply a "substantial likelihood" test in determining whether a misrepresentation is "material" so as to constitute a breach of fiduciary duty.[55] As the court in *Duke Energy* noted, such test for materiality "mirrors that used by the courts in analyzing securities fraud cases"[56] and does not provide any substantial independent protection to the interests of ESOP participants apart from what is already required by securities laws.[57]

3. "Phantom Stock" and Stock Option Bonus Plans

Finally, a phantom stock plan is a "long-term benefit plan under which a corporate employee is given units having the same characteristics as the employer's stock shares. The employee does not actually hold any shares but instead holds the right to the *value* of those shares."[58] In this regard, as the employee does not actually hold the employer securities, the law does not recognize any causes of action under securities laws.[59] ERISA also precludes coverage of phantom stock because unlike traditional savings plans, phantom stock and other "bonuses" serve as compensation as "an incentive or a reward for good work."[60] Thus, while phantom stock and other deferred compensation programs may not fulfill ERISA retirement goals, such plans nonetheless play an important role in employee

54. *See Kuper*, 66 F.3d at 1460; *Moench*, 62 F.3d at 571 (requiring knowledge of "impending collapse" in order to necessitate proper disclosure); *Duke Energy*, 281 F. Supp. 2d at 793 (same); *Wright*, 222 F. Supp. 2d at 1233-34.

55. *Duke Energy*, 281 F. Supp. 2d at 791 (citing James v. Pirelli Armstrong Tire Corp., 305 F.3d 439, 449 (6th Cir. 2002), Griggs v. E.I. Dupont de Nemours & Co., 237 F.3d 371, 380 (4th Cir. 2001), Mullins v. Pfizer, Inc., 23 F.3d 663, 669 (2d Cir. 1994), and Bunnion v. Consol. Rail Corp., 108 F. Supp. 2d 403, 415 (E.D. Pa. 1999)). Courts find materiality where "there [is] a substantial likelihood that [the misrepresentation] would have misled a reasonable participant in making an adequately informed decision about whether to place or maintain monies in" the fund in question. *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 442 (3d Cir. 1996).

56. *Duke Energy*, 281 F. Supp. 2d at 791.

57. *Id.*

58. BLACK'S LAW DICTIONARY (8th ed. 2004) (emphasis added). The court in *Whitt v. Sherman Int'l Corp.*, 147 F.3d 1325, 1327 (11th Cir. 1998) defines the interest as the "'right . . . to receive an award with a value equal to the appreciation of a share of stock from the date the Phantom Stock is cashed out . . . [and] are based on "phantom" or "hypothetical" shares or units.'" *Id.* (quoting Coopers & Lybrand, *Executive Summary of Nonqualified Longterm Incentive Plans*, CV01 ALI-ABA 619, 632 (1996)).

59. *See* Bodie, *supra* note 15, at 549-50. The author characterizes the stock options and phantom stock plans as "bonus plans" and posits that "[f]ederal courts have overwhelmingly found that bonus plans . . . are not pension plans . . . [because they] provid[e] current rather than retirement income." *Id.* at 597-98 (citing the Fifth Circuit's reasoning in *Murphy v. Inexco Oil Co.*, 611 F.2d 570, 576 (5th Cir. 1980). *See also* Wellman & Clark, *supra* note 25, at 667-68 (confirming that bonus programs are not part of the ERISA framework).

60. *In re* Enron Corp. Sec., Derivative, & "ERISA" Litig., 284 F. Supp. 2d 511, 530-31 n.2 (S.D. Tex. 2003) (citing Absher v. Flexi Int'l Software, Inc., No. Civ. 3:02CV171 (AHN), 2003 U.S. Dist. LEXIS 6089, at *6 (D. Conn. Apr. 10, 2003)). Phantom stock can, in very limited circumstances, fall within ERISA if its purpose is clearly "to provide retirement income." *See Murphy*, 611 F.2d at 575.

compensation packages, as they provide similar benefits to ESOPs and other stock ownership interests without actual ownership.[61] Unfortunately, given the gap between the statutes, employers may find that using such open forms of compensation shields from liability otherwise imposed under the securities laws or ERISA provisions.

III. RELEVANT STATUTES AND LEGAL CONSIDERATIONS

Thus, employees participating in ESOPs likely fall within the ambit of the securities laws and can benefit from the protections the Securities Acts provide. However, pension and savings plans likely do not qualify as "securities" for purposes of the Acts, therefore leaving the individuals claiming damages to their pension plans without remedies under securities laws. Accordingly, pension plan participants can pursue remedies merely under the ERISA statutory scheme, which sometimes even then does not adequately protect and compensate for their losses.

A. *The 1933 Securities Act & the 1934 Securities Exchange Act*

1. In General

Congress enacted two securities acts in 1933 and 1934 in reaction to the stock market crash of 1929 and the ensuing Great Depression.[62] The Acts mainly serve to "protect investors in the public marketplace by attaching consequences to the making, by registered companies, of inaccurate or misleading statements."[63] However, securities laws play a vital role in the employee deferred compensation context, as employer securities often comprise the bulk or the totality of plan investments.[64] And as the world saw in the past couple of years, alleged securities laws violations can

61. *In re Enron*, 284 F. Supp. 2d at 531.

62. *See, e.g.*, H.R. REP. NO. 73-85, at 11 (1933); J. Robert Brown, *Corporate Communications and the Federal Securities Laws*, 53 GEO. WASH. L. REV. 741, 742 & n.2 (1985).

63. Stein v. Smith, 270 F. Supp. 2d 157, 166 (D. Mass. 2003); *see also* S. REP. NO. 73-47, at 1 (1933) (positing that the "basic policy [of the 1933 Securities Act] is that of informing the investor of the facts concerning securities to be offered for sale . . . to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor").

64. All qualified "securities" buyers, which likely include ESOP participants and arguably include other purchasers of employer securities, fall within the protection of the Securities Act of 1933 and the Securities Exchange Act of 1934. *See generally* Reves v. Ernst & Young, 494 U.S. 56, 61 n.1 (1990) (finding that the definition of "security" is essentially parallel between the two Acts, encompassing the basic interpretations set forth in 15 U.S.C. §§ 77b(1) & 78c(a)(10)). *See also* 15 U.S.C. §§ 77b(1) & 78c(a)(10) (2000).

devastate employee deferred compensation accounts along with ordinary public investors.[65]

a. The 1933 Securities Act: The Regulatory Registration Provisions

i. In General

The 1933 Securities Act, 15 U.S.C. § 77a *et seq.*, controls the content of securities registration statements, documents required by the Securities and Exchange Commission as part of the trade and dealing of stock, and provides express remedies for registration violations and other misconduct in the offer to sell securities.[66] "The Securities Act of 1933 . . . was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing."[67] Generally, publicly-traded corporate entities are required to adhere to certain universal rules for the reporting of its financial status. Standards such as Generally Accepted Accounting Principles ("GAAP") provide uniform methods of measuring financial health to normalize record-keeping between companies and thus to help guide investors in their investment decisions.[68] However, the civil liability under the Securities Act for filing false or misleading registration statements serves mainly to encourage compliance with the Act and prevent negligent conduct in general, rather than necessarily providing compensation to any injured acquirers of a security.[69]

Under the 1933 Act, the Securities and Exchange Commission mandates that companies file Forms 10-K and Registration Statements as signed evidence of the entity's finances before offering a security.[70] The SEC filings purportedly afford investors some level of security and assurance by furnishing governmental regulation and penalties for non-compliance.[71] In particular, the 1933 Act specifically imposes civil liability for filing false

65. *See, e.g., In re Enron*, 284 F. Supp. 2d at 511; *In re* WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745 (S.D.N.Y. 2003).

66. *See* Securities Act of 1933, 15 U.S.C. § 77a *et seq.*

67. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

68. The Sarbanes-Oxley Act has officially defined and codified the use of "generally accepted" accounting methods for securities law purposes under 15 U.S.C. § 77s(b), which will be more thoroughly detailed upon the completion of the study ordered in Sarbanes-Oxley § 108(d).

69. Globus v. Law Research Serv. Inc., 418 F.2d 1276 (2d Cir. 1969).

70. 15 U.S.C. § 77e.

71. *See* § 77k (setting forth civil penalties for failure to register accurate statements). *See generally* § 77 ("1933 Act") & § 78 ("1934 Act"). "SEC filings are the quintessential statement on which a reasonable investor may rely and thus are the type of statement that can give rise to . . . action[s] against a defendant who signed them." *In re* WorldCom, Inc. Secs. Litig., 294 F. Supp. 2d 392, 417 (S.D.N.Y. 2003) (citing *In re* Ames Dept. Stores, 991 F.2d 968, 972 (2d Cir. 1993)); Thomson Kernaghan & Co. v. Global Intellicom, Inc., Nos. 99 Civ. 3005 & 99 Civ. 3015 (DLC), 2000 WL 640653, at *5 (S.D.N.Y. May 17, 2000); and *In re* JWP Sec. Litig., 928 F. Supp. 1239, 1256 (S.D.N.Y. 1996)).

registration statements in the initial offering of a particular security.[72] Particularly applicable to the employee investor context, the SEC specifically requires employers to file Forms S-8,[73] which mirror the Forms 10-K disclosure requirements for publicly traded securities under the 1934 Act.[74]

In theory, the ultimate responsibility under the 1933 Act lies internally with the company and its committees and directors, who are often the same individuals and entities acting as EIAP fiduciaries under ERISA. In particular, "[a]udit committees play a critical role in monitoring corporate management and a corporation's auditor."[75] By supervising and regulating SEC filings, the committees supposedly serve to catch and correct any errors or otherwise face liability.

ii. Recovery Under the 1933 Act

The 1933 Act expressly permits claims brought by anyone who "acquires" a security bearing a false or misleading registration statement against any person who signed the statement: issuing directors and partners, professional experts who certify the statement or whose assessments are used in the statement, and the security underwriters.[76] Specifically, the code regulates the statements by prohibiting the making of an "untrue statement of a material fact," an omission of a material fact required to be disclosed, or an omission of a material fact "necessary to make the [included] statements . . . not misleading."[77] Congress intended to "assure compliance with the disclosure provisions of the [Securities] Act by imposing a stringent standard of liability on the parties who play a direct role in a registered

72. 15 U.S.C. § 77k.

73. *See* EMPLOYEE BENEFIT PLANS, SECURITIES ACT RELEASE NO. 6281, FED. SEC. L. REP. P1052 (Jan. 15, 1981); REGISTRATION AND REPORTING REQUIREMENTS FOR EMPLOYEE BENEFIT PLANS, SECURITIES ACT RELEASE NO. 6867, FED. SEC. L. REP. P84605 (June 6, 1990).

74. 15 U.S.C. § 78*l*(g).

75. *In re WorldCom*, 294 F. Supp. 2d at 403; *see also* discussion *infra* regarding similar provisions under the 1934 Act. The court in *WorldCom* enumerated typical audit committee responsibilities set forth in a New York Stock Exchange Blue Ribbon Committee report, including "'ensuring that quality accounting policies, internal controls, and independent and objective auditors are in place to deter fraud, anticipat[ing] financial risks and promot[ing] accurate, high quality and timely disclosure of financial and other material information.'" *Id.* at 403 n.8.

76. 15 U.S.C. § 77k(a). "Section 11" as it is called

> provides that any signer, director of the issuer, preparing or certifying accountant, or underwriter may be liable if "*any part of the registration statement*, when such part became effective, *contained an untrue statement of a material fact or omitted to state a material fact* required to be stated therein or necessary to make the statements therein not misleading . . . ."

In re WorldCom, 294 F. Supp. 2d at 407 (citing 15 U.S.C. § 77k(a)).

77. *Id.*

offering."[78] Section 11 imposes strict liability for misleading representations regarding the viability of the investment in the company, prohibiting statements that "'taken together and in context, would have [misled] a reasonable investor' about the nature of the investment."[79] The purchaser then may sue for rescission or damages.[80]

Section 12 of the 1933 Act, 15 U.S.C. § 77*l*, also provides a remedy to investors for false communications regarding the propriety of investment in a company's securities.[81] The Code states in relevant part that an investor has a private right of action against a seller or solicitor who "offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements . . . not misleading."[82] Both sellers and solicitors can face liability, with underwriters included as "sellers" for purposes of section 12 causes of action.[83] Thus, the 1933 Act provides a number of strict liability[84] causes of action for any misrepresentations included in an *initial* registration statement of public securities.

b. The 1934 Securities Exchange Act: The Anti-Fraud Provisions for Holding Claims

Alternatively, the 1934 Securities Exchange Act provides a separate cause of action for defrauded securities buyers,[85] designating private rights of action for investors who fall victim to price and market manipulation and other related conduct[86] similar to the activities at Enron and WorldCom.

78. Herman & MacLean v. Huddleston, 459 U.S. 375, 381-82 (1983).

79. I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 761 (2d Cir. 1991) (quoting McMahon & Co. v. Wherehouse Entertainment, Inc. 900 F.2d 576, 579 (2d Cir. 1990)). Facts relevant to an informed investment decision are considered "material" for purposes of stating a section 11 cause of action, namely those pieces of information regarding the likely future of the company and other factors that may induce purchase, sale, or holding the particular corporate security. *See* Kronfeld v. Trans World Airlines, Inc., 832 F.2d 726, 732 (2d Cir. 1987).

80. 15 U.S.C. § 77*l*(a)(2) (stating that the injured party may "recover the consideration paid for such security with interest . . . less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security"); *see also* Commercial Union Assurance Co. v. Milken, 17 F.3d 608, 615 (2d Cir. 1994).

81. 15. U.S.C. § 77*l*.

82. *Id.* § 77*l*(a)(2).

83. *See* In re WorldCom Inc., Sec. Litig., 294 F. Supp. 2d 392, 408-09 (S.D.N.Y. 2003); *see also* Pinter v. Dahl, 486 U.S. 622, 642-47 (1988). *Pinter* imposes liability on immediate, not remote, sellers who "pass[] title, or other interest in the security, to the buyer for value" (*Pinter*, 486 U.S. at 644 n.21) as well as persons who "successfully solicit[] the purchase, motivated at least in part by a desire to serve [their] own financial interests or those of the securities owner." *Id.* at 647.

84. *See* 15 U.S.C. §§ 77k, *l*(a)(2), 78j(b); Gustafson v. Alloyd Co., 513 U.S. 561, 582 (1995) (holding that 15 U.S.C. § 77*l* does not require "proof of either fraud or reliance"); Shaw v. Digital Equip. Corp., 82 F.3d 1194 (1st Cir. 1996); *see also* Stein v. Smith, 270 F. Supp. 2d 157, 167 (D. Mass. 2003).

85. 15 U.S.C. § 78j(b).

86. *See id.* §§ 78i-j. *See also id.* § 78j(b); Dirks v. SEC, 463 U.S. 646, 654 (1983). In fact, section 10(b) provides the lone cause of action for pure *fraud* under the Securities Act. Beecher v. Able, 435 F. Supp. 397 (S.D.N.Y. 1977).

The 1934 Act serves to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry."[87] United States Code title 15, section 78(i), also known as Section 9 of the Securities Exchange Act,[88] prohibits the manipulation of security prices in relation to the purchase or sale of registered securities.[89] The Code provides that in

> [t]ransactions relating to [the] purchase or sale of [a] security[, i]t shall be unlawful for any person, directly or indirectly, by the use of the mails or any means or instrumentality of interstate commerce, or of any facility of any national securities exchange, or for any member of a national securities exchange . . . for the purpose of creating a false or misleading appearance of active trading in any security registered on a national securities exchange, or a false or misleading appearance with respect to the market for any such security . . . [or] to make, regarding any security registered on a national securities exchange, for the purpose of inducing the purchase or sale of such security any statement which was at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, and which he knew or had reasonable ground to believe was so false or misleading.[90]

Section 9 clearly approves personal liability for such violations, holding that

> [a]ny person who willfully participates in any act or transaction in violation of . . . this section, shall be liable to any person who shall purchase or sell any security at a price which was affected by such act or transaction, and the person so injured may sue . . . to recover the damages sustained as a result of any such act or transaction.[91]

Furthermore, under 15 U.S.C. § 78j(b), also known as "Rule 10(b)," fraudulent misrepresentations associated with the purchase or sale of securities constitute actionable conduct and generate a private right of action for the defrauded investors.[92] Rule 10(b) prohibits the use of "manipulative and deceptive devices" "in connection with the purchase or sale of [the] security."[93] The Code of Federal Regulations Rule 10b-5 provides the

87. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).
88. 15 U.S.C. § 78 (2004).
89. *Id.*
90. § 78i(a)(1)-(4).
91. § 78i(e).
92. *Id.* § 78j(b).
93. *Id.* The Code reads:

accompanying legal standard.[94] Individuals and entities face Rule 10(b) and 10b-5 liability where they "obtain[] (a) material, (b) nonpublic information intended to be used solely for a proper purpose and then (c) misappropriates or otherwise misuses that information (d) with scienter,[95] (e) in breach of a fiduciary duty, other duty arising out of a relationship of trust and confidence, to make 'secret profits.'"[96] Rule 10(b) and Rule 10b-5 thus require that the plaintiff show that the defendant acted with scienter[97] in misrepresenting and misusing the financial information to his own benefit.[98] Furthermore, plaintiffs are not limited to one statutory remedy within the 1934 Act and may sue under multiple sections.[99] Thus in essence, Rule 10(b) "protect[s] investors by serving as a 'catchall provision' which creates a cause of action for manipulative practices by defendants acting in bad faith."[100]

Furthermore, directors and officers who sign faulty registration statements and annual reports are still liable under the 1934 Act for any errors even without actually taking part in the preparation of the

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> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Id.

94. *See* 17 C.F.R. § 240.10b-5 (2004). Rule 10b-5 requires that a plaintiff prove (1) either a false statement of material fact or an omission of a material fact under circumstances warranting a duty to disclose, (2) scienter, (3) reasonable reliance upon the misrepresentations or omissions, and (4) proximate cause. Copansky v. Thompson, 58 F. Supp. 2d 682, 684-85 (E.D. Va. 1999) (citing Cooke v. Manufactured Homes, Inc., 998 F.2d 1256, 1260-61 (4th Cir. 1993)).

95. "Scienter is 'a mental state embracing intent to deceive, manipulate, or defraud.'" SEC v. Infinity Group Co., 212 F.3d 180, 192 (3d Cir. 2000) (quoting Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n. 12 (1976)). Scienter

> includes recklessness . . . [which encompasses] "highly unreasonable (conduct), involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care[] . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.

Id. (citations omitted).

96. SEC v. HealthSouth Corp., 261 F. Supp. 2d 1298, 1319 n.42 (N.D. Ala. 2003) (citing Dirks v. SEC, 463 U.S. 646, 654 (1983)); SEC v. Monarch Funding Corp., 192 F.3d 295, 308 (2d Cir. 1999); United States v. Newman, 664 F.2d 12 (2d Cir. 1981)).

97. "Scienter" entails showing that the "[d]efendants acted recklessly or with the intent to deceive, manipulate, or defraud." *Copansky*, 58 F. Supp. 2d at 685.

98. *Dirks*, 463 U.S. at 654.

99. Wolgin v. Magic Marker Corp., 82 F.R.D. 168, 172 (E.D. Pa. 1979). Many sections may apply to particular relevant conduct by the defendants, and the Securities Acts were not intended to constrain plaintiffs' avenues for relief. *See* Reves v. Ernst & Young, 494 U.S. 56, 60-61 (8th Cir. 1990) ("Congress painted with a broad brush . . . [and] did not attempt . . . to cabin the scope of the Securities Acts.").

100. *In re* WorldCom, Inc. Secs. Litig., 294 F. Supp. 2d 392, 410 (S.D.N.Y. 2003) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 206 (1976)).

statement.[101] The SEC posits that "by signing documents filed with the Commission, board members implicitly indicate that they believe that the filing is accurate and complete."[102] Similarly, the 1934 Act also imposes liability against "control persons" of entities or other individuals committing securities violations.[103] 15 U.S.C. § 78t(a), also known as "Section 20," mandates that

> [e]very person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.[104]

Therefore, the Securities Acts ostensibly provide a broad set of statutory remedies and regulations governing securities investments, especially in the cases of alleged fraud and other evident corporate misconduct.[105]

B. ERISA of 1974

On the other hand, most employee interests in employer securities do not fall within the ambit of the Securities Acts and are instead controlled by ERISA, 29 U.S.C. § 1001 *et seq.*

1. In General

ERISA is a "'comprehensive and reticulated statute,' the product of a decade of congressional study of the Nation's private employee benefit

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101. *See* Howard v. Everex Sys., Inc., 228 F.3d 1057, 1061-62 (9th Cir. 2000). The court asserted that

> [P]lacing responsibility on corporate officers . . . ensure[s] the validity of corporate filings . . . [and protects] investors . . . from misleading information. . . Key corporate officers should not be allowed to make important false financial statements knowingly or recklessly, yet still shield themselves from liability to investors simply by failing to be involved in the preparation of those statements. Otherwise, the securities laws would be significantly weakened.

Id.

102. S.E.C. Release No. 41987 ("Audit Committee Disclosure"), 1999 WL 955908, at *9 (Oct. 7, 1999); *see also supra* note 75 and accompanying text (discussing audit committee responsibilities under both Acts).

103. *See S.E.C. Release*, 1999 WL 955908, at *18-19 (referring to 15 U.S.C. § 78t(a)).

104. 15 U.S.C. § 78t(a) (2004).

105. The Securities Acts are further supplemented by the Sarbanes-Oxley Act of 2002. *See infra* Part V.

system."[106] As noted, ERISA generally governs pension plans and other employer provisions for savings and retirement.[107] Congress enacted ERISA for the express purpose of ensuring "fairer and more effective [pension plans] in providing retirement income for employees . . . "[108] whereas the Securities Acts were intended to protect investors from fraud and other misconduct with relation to the public trading of corporate securities.[109] ERISA only controls employee welfare benefit and pension benefit plans or some combination thereof.[110]

ERISA's provisions sound in the common law of trusts,[111] creating fiduciary status and resultant duties on those acting in a fiduciary capacity.[112] Fiduciary status is conferred either where the entity takes on the "functional" fiduciary obligations as set forth in section 1002(21) or where the ERISA plan expressly names an entity as a fiduciary.[113] The Code first bestows functional fiduciary status on persons and entities

> with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.[114]

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106. Mertens v. Hewitt Assoc., 508 U.S. 248, 251 (1993) (quoting Nachman Corp. v. Pension Benefit Guar. Corp., 446 U.S. 359, 361 (1980)).

107. *See* ERISA of 1974, Pub. L. No. 93-406, § 1001, 88 Stat. 829-1035.

108. H.R. REP. NO. 93-807, at 1 (1974).

109. *See supra* notes 66 & 86 and accompanying text.

110. 29 U.S.C. § 1002(1)-(3) (2004); *In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 530 n.2 (S.D. Tex. 2003). In this regard, bonus programs and "phantom stock" compensation do not constitute retirement or welfare benefits governed by ERISA. Wellman & Clark, *supra* note 25, at 667-68.

111. 29 U.S.C. § 1103(a) (2004) ("[A]ll assets of an employee benefit plan shall be held in trust."); *see also* § 1104 (enumerating the fiduciary duties); Gina Marie Agresta-Richardson, Comment, *Employee Stock Ownership Plans: Uncertainties Plaguing the Duties of the ESOP Fiduciary with Respect to Voting and Defensive ESOPs*, 14 AKRON TAX J. 91, 100-01 (1999) ("Section 404 evidences Congress's intent to adopt traditional notions of trust law to monitor fiduciary conduct . . . .").

112. *See* 29 U.S.C. §§ 1103-04 (2004).

113. *In re* Elec. Data Sys. Corp. ERISA Litig., 305 F. Supp. 2d 658, 665 (E.D. Tex. 2004) (citing *In re Enron*, 284 F. Supp. 2d at 543 and distinguishing between the creation of fiduciary status through a "functional" method specified by certain conduct or through "express designation by the ERISA plan documents").

114. 29 U.S.C. § 1002(21)(A) (2004). "[T]he definition of who is a fiduciary . . . is based on the person's functions, not the title conferred by the Plan." Kayes v. Pac. Lumber Co., 51 F.3d 1449, 1460 (9th Cir. 1995). ERISA does not, however, impose fiduciary liability for decision-making as to the basic structure of a plan. *See* Akers v. Palmer, 71 F.3d 226, 230 (6th Cir. 1995) (stating that "only actions respecting the *administration* or *management* of plan 'assets' are subject to fiduciary standards" (emphasis in original)).

Accordingly, "discretion [is] a sine qua non of fiduciary duty."[115] In addition, section 1102(a)(2) also specifies that ERISA plans may designate fiduciaries, called "named fiduciaries."[116]Thus, fiduciaries are subject to many of the same duties as imposed in trust law,[117] and ERISA, like the Securities Acts, also provides for co-fiduciary liability in certain circumstances.[118]

Fiduciary relationships, specific responsibilities, and directive authority under ERISA, including those created by functional fiduciary status, are generally set forth in the plan documents.[119] For example, Enron Corporation itself was a named fiduciary to the Enron Savings Plan, charged with the duty to appoint committee members to be Plan Administrator and the duty to generally administer the Plan except for investment of assets in the trust fund.[120] The plan documents stated that "Enron must provide the Administrative Committee with 'any information that the Committee determines is necessary for the proper administration of the Plan' and to the Trustee any such 'facts as are deemed necessary for the Trustee to carry out the Trustee's duties under the Plan.'"[121] The Savings Plan agreement also held that "Enron has sole discretion in appointing, removing and replacing the Trustee. [Thus,] Enron, although a Plan sponsor, is also a fiduciary to the Plan to the extent it exercises discretionary control and authority over

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115. Cottrill v. Sparrow, Johnson & Ursillo, Inc., 74 F.3d 20, 22 (1st Cir. 1996) (quoting Pohl v. Nat'l Benefits Consultants, Inc., 956 F.2d 126, 129 (7th Cir. 1992)).

116. Section 1102(a)(2) states that fiduciary status is bestowed upon:

> a fiduciary who is named in the plan instrument, or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (A) by a person who is an employer or employee organization with respect to the plan or (B) by such an employer and such an employee organization acting jointly.

Id.

117. *See infra* Part III-B-2-a for enumeration and explanation of fiduciary duties under ERISA.

118. 29 U.S.C. § 1105(a) (2004). A fiduciary may be held liable for the conduct of another fiduciary

> (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.

Id.

119. "[I]n reviewing the fiduciary's actions, the court must be *governed by the intent behind the trust*" and whether "adherence to the [Plan's] direction" is consistent with how the sponsor or settlor expect a prudent trustee to act. Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995) (emphasis added).

120. *In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 653 (S.D. Tex. 2003).

121. *Id.*

these specific matters."[122] Alternatively, the Enron ESOP bestows the "power to appoint, remove, and replace the trustee" on the Enron Board of Directors.[123] The Trustee then must "act on the [Administrative] Committee's directions" after the Committee determines "the extent to which the Trust Fund shall be invested in Company Stock and . . . the price at which Company Stock will be purchased or sold."[124] Thus, the fiduciary relationships and consequent responsibilities take on a contractual nature to a great degree[125] and turn upon the facts of each case,[126] in many cases leaving the plaintiffs without recourse against the individuals truly responsible for any plan losses.

2. Remedial Provisions Under ERISA

ERISA expressly permits a plan participant to sue an ERISA plan.[127] United States Code Title 29, section 1132(a)(1)(A)-(B) provides that a participant or beneficiary may sue individually "for the relief provided for in subsection (c) of this section, or . . . to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan."[128] Section 1132(a)(2) allows suit against fiduciaries for breaches of their duties enumerated in section 1109,[129] and the Secretary of Labor, participants, beneficiaries, and fiduciaries have standing to bring suit for such relief.[130] A participant, beneficiary or fiduciary may also sue "to enjoin any act or practice which violates any provision of this title or the terms of the plan, or . . . to obtain other appropriate equitable relief . . . to redress such violations or . . . to enforce any provisions of this title or the terms of the plan."[131] Furthermore, Federal Rule of Civil Procedure 17(a) does not preclude suit by plan participants and beneficiaries, because the employees, as beneficial owners, may "su[e] or join[] with the legal title holder if the

122. *Id.*

123. *Id.* at n.142.

124. *Id.*

125. *See, e.g.*, Beddall v. State St. Bank & Trust Co., 137 F.3d 12, 18 (1st Cir. 1998) (demonstrating the importance of the trust agreement in determining fiduciary relations and responsibilities).

126. *Compare In re* WorldCom, Inc., ERISA Litig., 263 F. Supp. 2d 745 (S.D.N.Y. 2003) (involving documents which enabled fiduciaries to eliminate investments in employer securities in the WorldCom 401(k) plans), *with* Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758, at *16-23 (W.D.N.Y. Jan. 14, 2004) (distinguishing the facts of *WorldCom* from the Corning Inc. Plan documents which required fiduciaries to maintain Corning stock as an investment option); *see also In re* CMS Energy ERISA Litig., 312 F. Supp. 2d 898, 907-909 (E.D. Mich. 2004) (comparing and contrasting the circumstances of the case with *In Re* McKesson HBOC, Inc., ERISA Litig., No. COO-20030RMW, 2002 U.S. Dist. LEXIS 19473 (N.D. Cal. Sept. 30, 2002) and Rankin v. Rots, 278 F. Supp. 2d 853 (E.D. Mich. 2003)).

127. 29 U.S.C. § 1132(a) (2004); *see also In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d at 511.

128. 29 U.S.C. § 1132(a)(1). *See* Wellman & Clark, *supra* note 25, at 685-86.

129. 29 U.S.C. § 1132(a)(2). *See* Wellman & Clark, *supra* note 25, at 685-86.

130. 29 U.S.C. § 1132(a)(2).

131. 29 U.S.C. § 1132(a)(3).

beneficial owner has the right sought to be enforced."[132] Therefore, even though the savings plans or ESOPs actually hold the investments, employees and other beneficiaries may still sue them because the employee participants and beneficiaries have the right to collect under and enforce the terms of the plan.

Section 1109, also known as ERISA section 409, expressly provides the basis for fiduciary liability in cases of breach, such as fraud. Specifically, section 1109 states that:

> Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter 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, including removal of such fiduciary.[133]

Additionally, section 1132(a)(2), or ERISA section 502(a)(2), expressly provides the cause of action.[134] Thus, the *plan* may sue fiduciaries in breach of their duties to "make good" the losses suffered by the plan. In addition, section 1132(a)(3) authorizes individual participants to sue individually instead of on the plan's behalf.[135] However, individual persons suing ERISA fiduciaries may seek limited relief.[136] And finally, courts have denied any extra-contractual relief[137] or punitive damages[138] in causes of action brought under the ERISA framework.

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132. Beasoechea v. Sverdrup & Parcel & Assoc., 486 F. Supp. 169, 173 (E.D. Pa. 1980).

133. 29 U.S.C. § 1109(a) (2004).

134. § 1132(a)(2) ("A civil action may be brought . . . by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 1109 of this title.").

135. § 1132(a)(3); *see* Steinman v. Hicks, 352 F.3d 1101, 1102-03 (7th Cir. 2003) (distinguishing between the different ERISA relief provisions and enumerating other supporting authority).

136. *See infra* Part IV-B-1-b for discussion of the Supreme Court's interpretation in *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209 (2002).

137. *See* Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134 (1985) (holding that ERISA does not expressly or impliedly authorize extra-contractual damages).

138. *Id.* The common law of trusts also prohibits punitive damages; thus, courts have followed both the *Russell* decision as well as the principles in trust law to find that ERISA does not allow the award of punitive damages. *See, e.g.*, Kleinhans v. Lisle Sav. Profit Sharing Trust, 810 F.2d 618, 627 (7th Cir. 1987).

a. Fiduciary Duties Under Section 1104

In general, ERISA fiduciaries must abide by certain statutory duties and accordingly face civil liability for breaching those duties to the plan participants and beneficiaries.[139] ERISA fiduciaries must 1) "act solely in the interests of the [Plan] participants and beneficiaries," 2) "act according to the terms of the plan," 3) administer the plan according to the prudent man standard of conduct, and 4) diversify the plan's investments so as to avoid unnecessary losses.[140] A fiduciary who has breached his duties to a plan "may be personally liable for the Plan's losses resulting from the breach [of fiduciary duty] and subject to any other equitable or remedial relief a court may deem appropriate."[141]

An ERISA fiduciary must adhere to the common-law fiduciary duty of loyalty to the plan and its participants, namely the employees,[142] and "discharge their obligations 'solely in the interest of the [plan] participants and beneficiaries.'"[143] One court aptly described the principle as one that requires execution of all Plan decisions "with an eye single to the interests of

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139. *See supra* note 132 and accompanying text.

140. Wellman & Clark, *supra* note 25, at 685-86. *See* 29 U.S.C. § 1104 (2004).
Section 1104(a) states that

> (1) Subject to sections 403(c) and (d), 4042, and 4044 [29 U.S.C. §§ 1103(c), (d), 1342, 1344] a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries;
>
> (ii) defraying reasonable expenses of administering the plan; and
>
> (B) 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;
>
> (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; and
>
> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and title IV.
>
> (2) In the case of an eligible individual account plan (as defined in section 407(d)(3) [29 U.S.C. § 1107(d)(3)]), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of any qualifying employer real property or qualifying employer securities as defined in section 407(d)(4) and (5) [20 U.S.C. § 1107(d)(4)-(5)]).

Id.; *see also* Penn. Fed'n, Bhd. of Maint. of Way Employees v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan, No. 02-9049, 2004 U.S. Dist. LEXIS 1987, at *8-9 (E.D. Pa. Feb. 4, 2004) (enumerating the fiduciary duties under section 1104 but calling the duty to "act 'solely in the interest of the participants and beneficiaries'" the "overarching principle of ERISA") (quoting 29 U.S.C. § 1104(a)(1)(A) (2004)).

141. Wellman & Clark, *supra* note 25, at 686 (citing to 29 U.S.C. § 1109 (2004)).

142. *See* 29 U.S.C. § 1104(a)(1); Cent. States, S.E. & S.W. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570-71 (1985); *see also* Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) ("To participate knowingly and significantly in deceiving a plan's beneficiaries in order to save the employer money at the beneficiaries' expense is not to act 'solely in the interest of the participants and beneficiaries.'").

143. Stein v. Smith, 270 F. Supp. 2d 157, 166 (D. Mass. 2003) (citing 29 U.S.C. § 1104(a)(1)).

the participants and beneficiaries."[144] Accordingly, a fiduciary also has the duty to "'act for the *exclusive* purpose' of providing benefits to plan beneficiaries."[145] Thus, a fiduciary who favors his own self-interest or the interests of a third party over those of the plan or its participants is liable for breach of the fiduciary duty of loyalty.[146]

Furthermore, ERISA imposes a duty to act as a "prudent man" under the circumstances.[147] Generally, the duty of prudence requires fiduciaries to properly assess the values and risks of a particular investment and to manage and execute the investments accordingly.[148] The duty of prudence has other significant limits, however, as it applies to ESOP administration only to the extent that the conduct at issue does *not* involve diversification of plan assets.[149] Moreover, ESOP fiduciaries enjoy a presumption that they have acted rationally and in good faith, much akin to the common law "business judgment rule."[150]

But most relevant to potential securities fraud involving employer stock, an ERISA fiduciary has a duty to diversify plan investments to avoid substantial losses, also governed by a "prudent man" standard of care.[151] Such diversification is an integral element to the current pending litigations in Enron, WorldCom, and the others, because the employee plans in those cases held most if not all their investments in the employers' securities.[152] Generally, a fiduciary must diversify the assets of the plan portfolio in order to guard against large losses to the plan.[153] The duty of prudence works concurrently with the duty to diversify, as the fiduciary must administer the plan, which includes managing the assets, such as a "prudent person, in a like capacity and familiar with such matters, would use under the

144. Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995) (quoting Berlin v. Mich. Bell Tel. Co., 858 F.2d 1154, 1162 (8th Cir. 1988)).

145. *Id.* (emphasis added); *see also Penn. Fed'n*, 2004 U.S. Dist. LEXIS 1987, at *9-10 (finding that plaintiffs did not adequately plead breach of duty to act for the exclusive purpose of participants and beneficiaries' benefits where failed to allege any fiduciaries' self-interested motives); Wright v. Or. Metallurgical Corp., 222 F. Supp. 2d 1224, 1232 (D. Or. 2002).

146. *See* 29 U.S.C. § 1104(a)(1); Wellman & Clark, *supra* note 25, at 694-95.

147. *See* 29 U.S.C. § 1104(a)(1)(B).

148. *See* Fink v. Nat'l Sav. & Trust Co., 772 F.2d 951, 955 (D.C. Cir. 1985) (citing Donovan v. Mazzola, 716 F.2d 1226, 1232 (9th Cir. 1983)).

149. § 1104(a)(2).

150. *See* Agresta-Richardson, *supra* note 111, at 100-02; *see also infra* note 313.

151. 29 U.S.C. § 1104(a)(1)(B).

152. *See In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 536 (S.D. Tex. 2003); *In re* WorldCom, Inc. Secs. Litig., 294 F. Supp. 2d 392, 397-400 (S.D.N.Y. 2003); *In re* Duke Energy ERISA Litig., 281 F. Supp. 2d 786, 788 (W.D.N.C. 2003).

153. *See* 29 U.S.C. § 1104(a)(1)(C); Wellman & Clark, *supra* note 25, at 696 (explaining that diversification constitutes a separate and distinct duty apart from the general prudence requirement in that "[e]ven where the investments themselves are relatively safe [i.e. in compliance with the duty of prudence], the failure to diversify may expose the plan . . . if the investments are illiquid").

circumstances."[154] However, ERISA also provides an exception from the duty to diversify for employer stock-based programs.[155] In those cases, the fiduciary need not diversify the assets; instead, the fiduciary need only invest in the employer securities as mandated in the plan agreements themselves.[156] Plan *administration* triggers fiduciary duties, but plan *design* does *not*.[157]

b. Other Fiduciary Responsibilities: Duties of Accuracy in Communication Regarding Plan Benefits and the Limited Duty to Disclose

Finally, analogous to the prohibitions under the Securities Acts[158] and a corollary to the duty of loyalty, a fiduciary cannot materially mislead a plan participant or beneficiary when speaking about a plan.[159] The "discretionary authority"[160] for imposing fiduciary status arises and creates fiduciary responsibilities where a plan administrator communicates with a plan participant.[161] Statements and misrepresentations cannot impose fiduciary liability unless it is shown that they constitute acts of "plan administration."[162] Conversely, "making intentional representations about the future of *plan benefits*," in the appropriate context, "*is* an act of plan administration."[163] Thus, establishing whether a particular action on the part of a corporate officer or director constitutes an act of fiduciary responsibility depends on whether the executive is clearly wearing his "fiduciary hat" when making the alleged representations,[164] a determination that relies on

154. Wellman & Clark, *supra* note 25, at 695 (citing § 1104(a)(1)(B)); *see supra* note 147 and accompanying text.

155. 29 U.S.C. § 1104(a)(2).

156. *See* Penn. Fed'n, Bhd. of Maint. of Way Employees v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan, No. 02-9049, 2004 U.S. Dist. LEXIS 1987, at *8-9 (E.D. Pa. Feb. 4, 2004). "ERISA further requires fiduciaries to comply with the plan as written unless it is inconsistent with ERISA." *Id.* at *10 (citing 29 U.S.C. § 1104(a)(1)(D)).

157. *In re* Xcel Energy, Inc, Sec., Derivative & ERISA Litig., 312 F. Supp. 2d1165, 1181 (D. Minn. 2004).

158. 15 U.S.C. § 78(j) (2004).

> A misrepresentation by a person, whose position made it reasonable for a plaintiff to rely upon that misrepresentation, about the value of a security, which was subsequently bought or sold by the plaintiff in reliance upon that statement, will satisfy the requisite "in connection with" a security for a § 10(b) claim.

In re Enron Corp. Sec. Derivative & ERISA Litig., 284 F. Supp. 2d 511, 566-67 (S.D. Tex. 2003) (citing *In re* Ames Dept. Stores, Inc. Stock Litig., 991 F.2d 953, 967 (2d Cir. 1993)).

159. Varity Corp. v. Howe, 516 U.S. 489, 506 (1996) (stating that "lying is inconsistent with the duty of loyalty owed by all fiduciaries and codified in section 404(a)(1) of ERISA") (citations omitted).

160. 29 U.S.C. § 1001(21)(A)(i), (iii) (2004).

161. *Varity Corp.*, 516 U.S. at 502-03; *see also In re Enron*, 284 F. Supp. 2d at 556.

162. *See Varity Corp.*, 516 U.S. at 505 (holding that "making intentional representations about the future of plan benefits [connected to statements about the company's financial health] is an act of plan administration").

163. *Id.* at 505 (emphasis added).

164. *Id.* at 506; *In re Enron Corp.*, 284 F. Supp. 2d at 565.

the facts of the specific situation.[165] The courts do not impose liability often, however, unless the conduct may amount to "insider trading" in violation of the Securities Acts.[166]

Much like the disclosure requirements under the Securities Exchange Act of 1934, ERISA also mandates disclosure of certain plan information to participants and beneficiaries.[167] "The duty of disclosure under ERISA has been described as 'an area of developing and controversial law.'"[168] Most courts do not require disclosure of material information when such data arises from business operations separate from an ERISA plan,[169] although some courts have imposed "an affirmative duty to disclose material information about which a plan participant would be unlikely to inquire."[170] But a plan administrator's duty to "offer beneficiaries detailed plan information" includes "conveying information about the likely future of plan benefits, thereby permitting beneficiaries to make an informed choice about continued participation."[171] Thus, *any* misrepresentation, which may include silence,[172] regarding the status of a corporation's "business health" amounts to "plan administration" under ERISA and triggers fiduciary responsibilities

165. *See* Stein v. Smith, 270 F. Supp. 2d 157, 173 (D. Mass 2003). Under the "two-hat doctrine," a corporate officer wears an "employer hat" and a "fiduciary hat," thus often subject to conflicting interests and, at times, conflicting fiduciary duties to the plan and to the corporation. *Id.*; *see also In re Enron*, 284 F. Supp. 2d at 550-51 (discussing the two-hat doctrine and distinguishing between business functions versus ERISA fiduciary functions).

166. *In re Enron Corp.*, 284 F. Supp. 2d at 565.

167. *See* 29 U.S.C. §§ 1022, 1024(b)(1), 1025(a); *see also Varity Corp.*, 516 U.S. at 503.

168. *In re* Xcel Energy, Inc. Sec., Derivative, & ERISA Litig., 312 F. Supp. 2d 1165, 1176 (D. Minn. 2004) (citing *In re Enron*, 284 F. Supp. 2d at 555).

169. Kling v. Fid. Mgmt. Trust Co., 270 F. Supp. 2d 121, 129 (D. Mass. 2003).

170. *In re Xcel Energy, Inc.*, 312 F. Supp. 2d at 1176; *see, e.g.*, Watson v. Deaconess Waltham Hosp., 298 F.3d 102, 114 (1st Cir. 2002); Anweiler v. Am. Elec. Power Serv. Corp., 3 F.3d 986, 991 (7th Cir. 1993). As one court hopefully stated, after the Enron litigation, more circuits will adopt an "affirmative fiduciary duty to disclose information beyond the traditional duties to disclose specified in the statute or the common law." Hill v. BellSouth Corp., 313 F. Supp. 2d 1361, 1368-69 (N.D. Ga. 2004). But nonetheless, even now, the general rule only requires disclosure under certain extreme circumstances. *Id.*

171. Varity Corp. v. Howe, 516 U.S. 489, 502-03 (1996). The duty to inform does not impose any duty to provide participants with "investment advice." *In re* Unisys Sav. Plan Litig., 74 F.3d 420, 443 (3d Cir. 1996). One court recently described the duty as one "where a fiduciary may need to provide information about the nature of an investment offering, but should not sway an investor one way or the other[, such as] disclos[ing] the relative risks associated with a particular fund as compared to other funds offered by the Plan." Penn. Fed'n, Bhd. of Maint. of Way Employees v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan, No. 02-9049, 2004 U.S. Dist. LEXIS 1987, at *15 (E.D. Pa. Feb. 4, 2004).

172. *See* Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Secs., Inc., 93 F.3d 1171, 1180 (3d Cir. 1996) (stating that ERISA fiduciary duty to inform plan participants and beneficiaries is "not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful") (quoting Bixler v. Cent. Penn. Teamsters Health & Welfare Fund, 12 F.3d 2192, 1300 (3d Cir. 1993)); *In re Xcel Energy, Inc*, 312 F. Supp. 2d at 1177.

where the proffered information serves to aid employee investors in their plan participation decisions.[173] For example, Enron included the erroneous and misleading SEC filings in its ERISA Summary Plan Descriptions distributed to employees, allegedly fraudulently inducing investment in over-valued stock as opposed to other more stable investment options.[174] Furthermore, as in WorldCom's case, the Summary Plan Descriptions ironically included the SEC reports so as to *ensure* the "safety and value of the WorldCom stock-investment alternative within their 401(k) plan."[175] Thus, inducement to invest in these companies' stock theoretically constitutes claims for breach of fiduciary duties of loyalty and prudence.[176]

Moreover, failure to correct such misinformation, as in the case of Enron, also invokes fiduciary duties.[177] Plan administrators must investigate a company's financial health and the propriety of plan investments in such company's stock,[178] a requirement tied to the duty of prudence.[179] Therefore, breach of fiduciary duty under ERISA pension plans actually sound in securities fraud to a certain degree,[180] as often times misrepresentations regarding the value of employer stock constitute the relevant fiduciary conduct giving rise to liability, akin to section 78j of the Securities Exchange Act. But fortunately enough for a few plaintiffs, overlapping recovery under securities statutes does not automatically dismiss an ERISA claim where the defendants are charged with the breach of fiduciary duties to disclose accurate information regarding stock prices parallel the "duties of disclosure owed by a corporation and its officers to the corporation's shareholders,"[181] sometimes providing multiple viable causes of action.[182]

173. *See Varity Corp.*, 516 U.S. at 502-03; *In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 558 (S.D. Tex. 2003). As an example, in the Enron ERISA litigation, the plaintiffs have successfully alleged that Enron and the Compensation Committee breached their fiduciary duty to provide information necessary for Plan Administration, facts which in turn lead to a finding of breach of a fiduciary duty to investigate. *Id.* at 537. The plaintiffs in *Enron* have offered clear evidence that Enron directors all sold stock despite "exhorting" further purchases by employee plan participants. *Id.*

174. *In re Enron*, 284 F. Supp. 2d at 637.

175. Vivien v. WorldCom, Inc., No. C 02-01329 WHA, 2002 U.S. Dist. WL 31640557, at *7 n.3 (N.D. Cal. July 26, 2002).

176. *In re Enron*, 284 F. Supp. 2d at 533.

177. *See id.* at 658-59. Additionally, the ERISA plaintiffs in *Enron* have also successfully alleged a breach of fiduciary duty in the fiduciaries' conduct in causing and allowing Savings Plan to purchase and accept matching contributions in Enron stock once the fiduciaries knew that it was risky. *Id.* at 533.

178. *See id.* at 547-48.

179. *See supra* note 154 and accompanying text.

180. *See* Vivien v. WorldCom, Inc., No. C 02-01329 WHA, 2002 U.S. Dist. WL 31640557, at *8 (N.D. Cal. July 26, 2002).

181. *Id.* (distinguishing Hull v. Policy Mgmt. Sys., No. CIV.A.3:00-778-17, 2001 WL 1836286, at *5-8 (D.S.C. Feb. 9, 2001)). The court in *Vivien* read the holding in *Hull* narrowly to its facts, as the employer in *Hull* had explicitly spelled out fiduciary duties in the plan which did not include the duty to provide accurate information. *Id.* at *7. Instead, the court decided that *Hull* merely stood for the proposition that only where the fiduciary duties are expressly limited should a court dismiss ERISA claims alleging conduct that "amount[] to fraud on the market." *Id.*

182. Unfortunately for other plaintiffs, however, many employees cannot state actionable claims under either statutory scheme and will not recover at all. *See infra* Parts IV-A-2 & V-C.

IV. THE OVERLAPS IN THE CURRENT STATUTORY FRAMEWORK AND WHY BLINDLY "APPLYING THE SECURITIES LAWS" DOES NOT ADEQUATELY SUPPLEMENT THE ERISA STATUTORY FRAMEWORK: THE NEED FOR UNIFORM HIGH STANDARDS OF REGULATION AND PROTECTION FOR ALL EMPLOYEE INVESTMENT PLANS

A. Securities Laws Already Apply to a Limited Degree yet Do Not Sufficiently Account for All Employee Investing Concerns Because Only Certain Programs Qualify for Protection Under the Securities Acts

Where the relevant conduct is not "plan administration" subject to the fiduciary standards of ERISA, some plaintiffs *may* state a claim for relief instead under the securities laws.[183] As explained above, an employee stock benefit or pension plan constitutes a "security" under the Securities Exchange Act of 1934 depending on whether the plan is voluntary versus involuntary and individually contributory as opposed to noncontributory.[184] The Securities Exchange Act regulations apply to employee interests in a stock-based plan only where employees voluntarily participate in and individually contribute to the plan.[185] Voluntary contribution plans amount to investment contracts akin to securities.[186]

Some commentators contend that applying the Securities Acts across the board to certain stock-based programs as a supplement to ERISA would ameliorate employee stockholder concerns by entitling employees to the same protections available to public investors.[187] While such a proposal may hold true, it is nonetheless short-sighted and limited, as it fails to address the even more pressing and long-term needs explicitly intended in the ERISA statutory scheme. As noted above, ERISA seeks to ensure "fairer and more effective [programs] in providing retirement income for employees[,]"[188] and while the Securities Acts provide causes of action for serious misconduct, employee investors still need safeguards by requiring heightened standards of ERISA fiduciary duties to guarantee that their funds are safe. Therefore, the main sticking point between the two statutory schemes lies in the fact that the laws, and thus the legal bases for recovery, apply inconsistently to

183. Stein v. Smith, 270 F. Supp. 2d 157, 173 & n.4 (D. Mass 2003).

184. *See* Employee Benefit Plans, SEC Release No. 33-6188, 1 Fed. Sec. Rep. (CCH) ¶ 1051 at 2073-6 n.19-20 (Feb. 1, 1980) ("SEC Release"); *In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 636-40 (S.D. Tex. 2003).

185. SEC Release, at 2073-3, 7; *see In re Enron*, 284 F. Supp. 2d at 639-40.

186. SEC Release, at 2073-9; *see also* Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979).

187. *See, e.g.*, Hogle, *supra* note 26 (arguing that ESOPs should have express remedies under the Securities Acts).

188. H.R. REP. NO. 93-807, pt. 1, at 4670 (1974).

EIAPs despite involving the same alleged conduct, the same employer securities, and the same losses. It seems ironic, however, that the interests of retirement plans cannot enjoy at least the same level of comfort as the investing public.

1. Overlap of the Securities Laws over ERISA in ESOP Administration Already Produces Inconsistent Results

a. ESOPs as Securities

It is clear that a typical ESOP does not possess the "pension-type" secure deferred compensation that ERISA purports to regulate,[189] as an ESOP "does not have the primary indicia of a pension plan—*i.e.*, the payment of benefits *only* upon retirement."[190] One commentator has stated that

> [t]he substitution of an ESOP for compensation the employee would otherwise have been entitled to receive in cash is not likely to produce future compensation for the employee actuarially (or otherwise) equivalent in value to the foregone cash compensation. . . . [A]n employee could receive much less than the foregone compensation if the company performs poorly. *This risk factor makes the substitution of the ESOP resemble much more the acquisition of an equity interest in a company than an ordinary deferred compensation arrangement.*[191]

Characterizing ESOPs as securities has instigated a great deal of legal controversy, as courts have struggled with the interpretation of the Supreme Court holding in *International Brotherhood of Teamsters v. Daniel*, [192] which defined "compulsory"[193] and "noncontributory"[194] as the dispositive factors in determining whether to classify an interest in employer stock as a "security."[195] While several courts have refused to apply federal securities laws to ESOPs,[196] most have found ESOPs to fit the definition of "security" as set forth in *Daniel* and the earlier *SEC v. W.J. Howey Co.*[197] *Howey* used

189. *See* Stanley Keller, *Employee Equity Incentive Arrangements*, 19 REV. OF SEC. & COMMODITIES REG., 156 (1986) (distinguishing between an "investment securities plan" and a "compensatory securities plan").

190. Hood v. Smith's Transfer Corp., 762 F. Supp. 1274, 1290 (W.D. Ky. 1991) (emphasis added).

191. Mario L. Baeza & Laura A. Taylor, *The Applicability of Federal Securities Laws to Employee Bargained-For ESOPs*, 680 PRAC. L. INST. CORP. 703, 717-18 (1990) (emphasis added).

192. Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 566-67 (1979).

193. "Compulsory" indicates that the employer imposed the benefit plan as a condition of employment. *See Daniel*, 439 U.S. at 553.

194. "Noncontributory" meant that "[t]he employees paid nothing to the plan themselves." *Id.*

195. *See id.* at 566-67; *see also* Bodie, *supra* note 15, at 555-58; Hogle, *supra* note 26, at 197.

196. *See, e.g.*, Childers v. Northwest Airlines, Inc., 688 F. Supp. 1357 (D. Minn. 1988).

197. 328 U.S. 293 (1946).

the term "investment contract" to define a "security": an investment contract is a "scheme involv[ing] an investment of money in a common enterprise with profits to come solely from the efforts of others."[198] *Daniel* in turn split the *Howey* rule into two elements: the compulsory and non-contributory nature of the program.[199] Thus, technically an ordinary ESOP such as the ones at issue in Enron, WorldCom, and others, fits the "investment contract" mold akin to the pension plan in the *Daniel* case, as the employees' stock is only distributed when the interest has vested, in turn giving rise to the "investment contract" analysis under *Daniel* and *Howey*.[200] Additionally, as noted above, the essence of the ESOP is employee stock distribution and ownership, just like in the public marketplace, which by itself intuitively constitutes a "security."[201] Therefore, courts finding that ESOPs amount to securities point out that the basic "'fundamentals of the underlying transaction'—namely, the distribution of employer stock to employees[,]" likely render an ESOP subject to the securities laws.[202] Thus, it is arguably somewhat settled that "ESOPs constitute certificates of interest or participation in stock and therefore fall within the purview of the [Securities] Acts by default."[203]

b. ESOPs and Their Technical Classification Under ERISA

Thus, an ESOP surpasses the scope of ERISA in that it arguably falls within the definition of a "security" for purposes of the 1933 and 1934 Acts. There, as a "security," ESOP participants may state causes of action under sections 77 and 78 for fraudulent misrepresentations and other conduct

198. *Id.* at 301.

199. Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979) ("We hold that the Securities Acts do not apply to a noncontributory, compulsory pension plan.").

200. *Id.*

201. *See* Yoder v. Orthomolecular Nutrition Inst., Inc., 751 F.2d 555, 558 (2d Cir. 1985) ("Stock is indubitably a security within the definitions of the Securities Act[s]."). Courts also look to the parties' reasonable expectations, specifically the circumstances of the "sale," to determine whether the employee purchaser believed that the Securities Acts would govern the transactions, see Hood v. Smith's Transfer Corp., 762 F. Supp. 1274 (W.D. Ky. 1991), as well as to what extent the ESOP in question more closely resembles traditional stock or traditional pension programs. *See* Harris v. Republic Airlines, Inc., CIVA No. 86-2147 1988 WL 56256 at *7 (D.D.C. May 19, 1988) (holding that an employee agreement to join an ESOP for salary reductions and the current surrender of pension plan participation is a transaction governed by securities laws because the deal constituted not only income deferral but also a "fairly speculative capital investment in the Company[, as the employees] were not simply being asked to accept the same compensation package in a different—presumably deferred—form"). *See also* Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985); *Hood*, 762 F. Supp. at 1274.

202. Bodie, *supra* note 15, at 557-58 (quoting Harris v. Republic Airlines, CIVA No. 86-2147 1988 WL 56256 at *10 (D.D.C. May 19, 1988)).

203. *See* Hogle, *supra* note 26, at 240 (citing *Landreth*, 471 U.S. at 681, to argue that ESOPs absolutely fall within the Securities Acts).

relating to the purchase of their company stock.[204] But in principle, ESOP programs constitute repeated sales of employer stock to the employee buyer[205] as a form of deferred compensation governed by ERISA.[206] The causes of action under the 1933 and 1934 Acts and ERISA are not mutually exclusive though; in fact, the two statutory schemes supplement each other in the ESOP context,[207] with ERISA's restricted remedial provisions arguably taking a weaker position to the expansive causes of action available under the securities laws.[208]

Notwithstanding the arguments for classifying ESOPs as securities and thus permitting causes of action under both statutory schemes, ERISA still technically regulates the administration of ESOPs. However, the securities laws merely pick up the slack where ERISA falls terribly short in protecting the financial interests of ESOP participants. Admittedly, an ESOP fiduciary is still governed by the traditional ERISA duties of loyalty and prudence.[209] But an ESOP fiduciary does *not* have a duty to diversify the ESOP's investments,[210] and courts construe the limited exceptions, such as the duty to investigate, very narrowly.[211] Instead of expressly requiring an ESOP fiduciary to meet the same requirements that the other deferred compensation plans' fiduciaries must meet, the ESOP fiduciaries, who are often one in the same as those entrusted with the other plans' administration, face taking inconsistent actions in managing the different plans. Courts have excused the exemption by positing that ERISA still specifically mandates that an ESOP trustee act prudently[212] and in the best interests of the Plan and its participants and beneficiaries,[213] which supposedly imposes the duty to diversify in a limited sense, namely diversifying when investment in the employer stock no longer constitutes a "prudent" investment.[214]

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204. *See, e.g.*, *Yoder*, 751 F.2d at 555; *Hood*, 762 F. Supp at 1274.

205. *See* Employee Benefits Plan, Exchange Release No. 33-6188, 1980 WL 29482 (Feb. 1, 1980) (finding that individual stock agreements constitute "sales of securities" for purposes of the Acts).

206. *See* 29 U.S.C. § 1107(d)(3) (2004).

207. *See, e.g.*, Uselton v. Commercial Lovelace Motor Freight, 940 F.2d 564, 581-86 (10th Cir. 1991) (holding that ERISA did not preempt the Securities Acts).

208. *See id.* (finding that ERISA did not preempt causes of action under the 1933 and 1934 securities acts because ERISA does not require "'relevant, accurate information upon which to base an investment decision'" to be disclosed nor does it account for fraudulent conduct or misrepresentations) (citations omitted); *see also* Hogle, *supra* note 26, at 229-34 (calling the theories of relief under ERISA an "inadequate substitute for the protections afforded by the Securities Acts" in arguing for the express application of securities laws to ESOP plans).

209. Kuper v. Iovenko, 66 F.3d 1447, 1458 (6th Cir. 1995).

210. 29 U.S.C. § 1104(a)(2) (2004). However, the duty to diversify applies in a limited sense when the employee in question nears retirement. *See* Michael W. Melton, *Demythologizing ESOPs*, 45 TAX L. REV. 363, 397 (1990); *see also* Blum, *supra* note 38, at 1554 & n.65 ("[Approaching retirement] represents one of the few instances where the retirement security policies of ERISA win out over employee stock ownership.") (citing Melton, *supra* note 210, at 397).

211. *Kuper*, 66 F.3d at 1460 (finding that although fiduciaries who do not adequately investigate and assess the viability of investment in employer securities only provides a narrow exception to the general presumption that diversification in an ESOP portfolio is not required).

212. 29 U.S.C. § 1104(a)(1).

213. *Id.*

214. *Kuper*, 66 F.3d at 1458.

Accordingly, courts suggest that investment in a faltering company may constitute a violation of that fiduciary duty of prudence,[215] which in turn would give rise to an action under 29 U.S.C. § 1109(a). Thus, ESOPs are clearly subject to lesser standards of fiduciary care, apparently an element of their "investment" character.[216] Nonetheless, even though the duty of prudence and the duty to "administer the plan solely in the interests of plan participants" are standards applicable to all programs under the ERISA statutory framework, by continuing to completely exempt ESOPs from the duty to diversify will not only cause problems of administration in requiring different standards of conduct but more importantly, in cases of fiduciary misconduct, will likely also produce further inconsistent results between ESOPs and other eligible account plans in litigated cases.[217]

2. The Loophole Between Securities Laws and the RICO Amendment Entirely Bars Certain Plaintiffs from Recovery

Furthermore, EIAP plaintiffs generally cannot sustain RICO claims because "[w]here RICO predicate offenses are an integral part of and sustain an alleged securities fraud Ponzi scheme,[218] they are intrinsically conduct undertaken 'in connection with the purchase or sale of securities' and are barred by the RICO Amendment."[219] The RICO Amendment provides that "embezzlement, mail and wire fraud, obstruction of justice, and interstate transportation offenses" combine to form the same, singular scheme that constitutes the basis for the securities actions under Title 15, therefore barring duplicate causes of action.[220] However, essentially consolidating RICO actions into securities litigation cuts certain plaintiffs off from recovery. Phantom stock program and bonus plan participants "fall through the cracks" because the interests involved do not constitute actionable

215. Moench v. Robertson, 62 F.3d 553, 572 (3d Cir. 1995).

216. *See* Steinman v. Hicks, 352 F.3d 1101 (7th Cir. 2003) (holding that the duty to diversify only applies in a very limited manner in the ESOP context but that the duty of prudence still applies).

217. *Kuper*, 66 F.3d at 1458 ("Thus, 'ESOP fiduciaries ... are expected to administer ESOP investments consistent with the provisions of both a specific employee benefits plan and ERISA' ... These competing concerns make it more difficult to delineate the responsibilities of ESOP trustees.") (citations omitted).

218. *See* BRIAN CRUVER, ANATOMY OF GREED: THE UNSHREDDED TRUTH FROM AN ENRON INSIDER 180 (Carroll & Graf 2002) [hereinafter ANATOMY OF GREED] (defining the term "Ponzi scheme" as a reference to Charles Ponzi, the 1920's con man who defrauded investors into giving him $9.5 million on false assurances that he could make a 50 percent return in less than two months and later faced bankruptcy and jail time when his scheme died out).

219. *In re* Enron Secs. & Derivative Litig., 284 F. Supp. 2d 511, 648-49 (S.D. Tex 2003) (citing and quoting Bald Eagle Area Sch. Dist. v. Keystone Fin., Inc., 189 F.3d 321, 329-330 (3d Cir. 1999)). The RICO Amendment, Pub. L. No. 104-67, § 107, 109 Stat. 737, 758 (1995), adds to 18 U.S.C. § 1964(c).

220. *In re Enron*, 284 F. Supp. 2d at 648-49; *see also Bald Eagle*, 189 F.3d at 329-30.

"securities" within the meaning of the Securities Acts, and the RICO Amendment still bars their claims for fraud for losses suffered by the decline in value of their holdings.[221] Therefore, although "plan participants' actual losses in essence are the same financial losses suffered by all . . . shareholders,"[222] not all plaintiffs can successfully assert claims under the Securities Acts and yet cannot find legal relief elsewhere.

B. ERISA's Shortcomings

The recent scandals clearly caught the financial world and employee investors alike off guard, and federal laws were simply not prepared to cope with the flood of diverse claims under almost every one of the multitude of different employee programs. Thousands of employees lost their entire livelihoods under ERISA-governed programs based on employer securities, whether ESOP or traditional individual deferred compensation plans, and have filed complicated, "kitchen-sink" style suits claiming damages against innumerable defendants in hopes of recovering even a portion of what was lost from the faltering, now-bankrupt corporations and those agents who perpetrated the costly misconduct.

1. Section 404(c) Defenses Strictly Limit the Imposition of Liability

First, where the plan participants exercise some level of control over the investment choices of his or her pension fund, the persons or entities otherwise serving as fiduciaries may in fact enjoy immunity from liability for breach of the fiduciary duties under ERISA.[223] Section 1104(c)(1)(B) holds that

> In the case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account (as determined under regulations of the Secretary)— . . .
>
> (B) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control.[224]

"Whether a participant or beneficiary has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case."[225]

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221. *In re Enron*, 284 F. Supp. 2d at 652.
222. *Id.* at 649.
223. *See* 29 U.S.C. § 1104(c)(1)(B).
224. *Id.*
225. 29 C.F.R. § 2550.404c-1(c)(2).

For example, the Enron Savings Plan Trust Agreement designated the Northern Trust as the Savings Plan Trustee and enumerated its fiduciary responsibilities and powers.[226] The ESOP Trust Agreement similarly designated the Trustee and Administrative Committee with the same fiduciary duties and powers.[227] WorldCom, by contrast, offered employees some level of control over plan diversification and investment choices, facts which may lead to section 404(c) immunity for the defendants.[228] Ordinarily, liability for another's investment choices would not make any sense. But employer securities are a different breed, as the world has seen: employees invest in their employer's stock not only in reliance on upper management recommendation but also without full knowledge of many company circumstances just as a public investor, choosing to participate in support of the entity that purportedly sustains their livings, often as part of a collectively-bargained agreement and hardly with any extra "insider" information.[229] It is no longer appropriate to assume that because an employee works for a particular organization that he knows everything that happens and can make better informed decisions about his investments than the public. Bestowing blanket immunity to fiduciaries in cases where employees exercise discretion over their deferred compensation account

226. *In re Enron*, 284 F. Supp. 2d at 654-55. While the Northern Trust had a duty of "holding, managing, caring for and protecting the assets of the Plan, including investing and reinvesting those assets, [and] su[ing] or defend[ing] claims against the Trust Fund," it also provides that the Trustee may "compromise, contest, prosecute or abandon claims in favor or against the Fund." *Id.* at 654 n.144 (citing Article V of the Savings Plan Trust Agreement). Furthermore, the Savings Plan also explicitly sets forth Northern Trust's fiduciary duties, stating:

Notwithstanding Article Five:

> 6.1 The powers of the Trustee shall be exercisable for the exclusive purpose of providing benefits to the Participants and Beneficiaries under the Plan and in accordance with the standards of a prudent person under ERISA;
>
> 6.2 Subject to 6.1 and 6.3, the Trustee shall diversify the investments of that portion of the fund of which it has investment responsibility so as to minimize the risk of large losses;
>
> 6.3 Subject to 6.1, the Trustee shall, with respect to that portion of the Fund for which it has investment responsibility, follow the investment guidelines established by the Administrative Committee and shall act in accordance with the direction of the Administrative Committee.
>
> 6.7 No provisions of Sections 6.5 or 6.6 [addressing direction of the trustee by plan participants] shall prevent the Trustee from taking any action relating to its duties under Sections 6.5 or 6.6 if the Trustee determines in its sole discretion that such action is necessary in order for the Trustee to fulfill its fiduciary responsibilities.

Id. at 655.

227. *Id.*

228. *See* discussion *infra*; *see also* Vivien v. WorldCom, Inc., No. C 02-01329 WHA, 2002 U.S. Dist. WL 31640557, at *6 (N.D. Cal. July 26, 2002).

229. *See* Bodie, *supra* note 15, at 575-76 (positing that Enron's collapse "provides a contemporary example of the differences in information access between high-level executives and lower-level employees").

investments will only help perpetrate further frauds and more future losses to plans and their participants.

2. Interpretations of ERISA Pose Further Hurdles to Plaintiffs' Recovery in Claiming Breach of Fiduciary Duty

In theory, Congress proposed that "ERISA is considered to be a remedial statute, and remedies are to be liberally construed."[230] But often times, plaintiffs find themselves without remedy for breaches of fiduciary duty under courts' stringent statutory interpretations. Generally, a claim for breach of fiduciary duty under ERISA requires the plaintiff to show that the defendant was a plan fiduciary and breached a fiduciary duty while acting within the fiduciary capacity.[231] Establishing that companies, administrative committees, and individual directors and officers *had* fiduciary responsibilities to plan participants poses one significant legal hurdle for the plaintiffs to overcome.[232] Furthermore, unlike the Securities Acts, in cases of alleged fraud often times the misrepresentations or other misconduct in question do not or cannot state a claim for relief based on the stringent, technical standards set forth in case precedent.

a. Plaintiffs Claiming Breach of EIAP Fiduciary Duty to Diversify Can Rarely Surmount the Stringent "Abuse of Discretion" Standard

While supposedly imposing fiduciary duties giving rise to civil liability would appear to provide ample deterrence for any violations thereof, Enron and its contemporaries have proven the critics to be right,[233] as the duty to "act solely for the benefit of plan participants" has not afforded sufficient protection.[234] Adding insult to injury, courts have in turn applied the "abuse of discretion" standard to plan diversification issues rather unforgivingly, only finding an actual violation of fiduciary duty in very limited circumstances.[235]

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230. Wellman & Clark, *supra* note 25, at 703. *See* H.R. REP. NO. 93-533, at 17, *reprinted in* 1974 U.S.C.C.A.N. 4639, 4655 (stating that ERISA serves to provide "participants and beneficiaries with broad remedies for redressing or preventing violations of the Act").

231. 29 U.S.C. § 1109 (2004); Pegram v. Herdrich, 530 U.S. 211, 255-56 (2000).

232. *See, e.g.*, Vivien v. WorldCom, Inc., No. C 02-01329 WHA, 2002 WL 31640557, at *3-4 (N.D. Cal. July 26, 2002). Persons and entities other than the "named fiduciary" gain fiduciary status depending on conduct and authority, as "ERISA . . . defines 'fiduciary' not in terms of formal trusteeship, but in *functional* terms of control and authority over the plan." Mertens v. Hewitt Assocs., 508 U.S. 248, 262 (1993); *see* 29 U.S.C. § 1002(21)(A) (2004). Thus a "person's actions, not the official designation of his role," dictates whether to impose fiduciary responsibility. Acosta v. Pac. Enter., 950 F.2d 611, 618 (9th Cir. 1991).

233. *See* Dougall, *supra* note 15, at 719 (calling the ERISA fiduciary duty to act solely for participants' benefits "insufficient in practice" because of divergent "interested constituencies").

234. *See* Blum, *supra* note 38, at 1557 (stating that, in the ESOP context, the "abuse of discretion standard serves little purpose").

235. *See* Moench v. Robertson, 62 F.3d 553, 572 (3d Cir. 1995) (describing situation where an employer issuer faced "impending collapse" as circumstances potentially warranting the imposition of the duty to diversify in the ESOP context); *see also* Kuper v. Iovenko, 66 F.3d 1447, 1460 (6th Cir. 1995) (finding that holding employer securities even when the stock prices fell did not constitute

The Third Circuit in *Moench v. Robertson*[236] devised a presumption that an EIAP fiduciary did not "abuse discretion" by investing in the employer's stock.[237] Under *Moench*, "an [EIAP][238] 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,"[239] a principle founded on ERISA's relationship to traditional trust law.[240] Thus *Moench* effectively raised the burden for plaintiffs claiming fiduciary violations. For one, ESOPs would rarely fall victim to an "abuse of discretion," as there is simply not very much room for fiduciaries to act in the first place because ESOP plan specifications, by definition, require that the fiduciary invest in a certain high percentage of employer stock.[241] Additionally, as ESOP fiduciaries are not subject to the duty to diversify,[242] the duties to "act in the participants' best interests" and to "act prudently" [243] stand as the sole remedies for many cases of misconduct,[244] and often the losses suffered sound too close to portfolio diversification arguments to constitute actionable claims.[245]

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a breach of fiduciary duty); Wright v. Or. Metallurgical Corp., 222 F. Supp. 2d 1224, 1233-34 (D. Or. 2002) (denying plaintiffs relief where no allegations of "unusual circumstances that would give rise to an exception to the general rule that an ESOP fiduciary's decision to hold employer stock is consistent with ERISA's prudence requirement").

236. 62 F.3d 553, 571 (3d Cir. 1995).

237. *Id.* The Ninth Circuit has recently followed the Third Circuit's lead, adopting the *Moench* standard of review in *Wright v. Oregon Metallurgical Corp.*, 360 F.3d 1090, 1099 (9th Cir. 2004).

238. While *Moench* specifically dealt with an ESOP, its test applies to all EIAPs, including both ESOPs as well as traditional 401(k) pension plans. *See* Penn. Fed'n, Bhd. of Maint. of Way Employees v. Norfolk S. Corp. Thoroughbred Ret. Inv. Plan, No. 02-9049, 2004 U.S. Dist. LEXIS 1987, at *21-22 (E.D. Pa. Feb. 4, 2004) (rejecting plaintiffs' argument that the *Moench* presumption does not apply to their 401(k) program fiduciaries and stating instead that "the distinction between ESOP and other types of EIAPs, such as profit sharing plans and savings plans, is irrelevant").

239. *Moench*, 62 F.3d at 571 (emphasis added).

240. *Id.* at 566 (relying on the Restatement (Second) of Trusts section 187 to state that "[w]here discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion"); *see also* *Penn. Fed'n*, 2004 U.S. Dist. LEXIS 1987, at *22 (quoting *Moench*, 62 F.3d at 566).

241. *See* Blum, *supra* note 38, at 1555-56.

242. 29 U.S.C. § 1104(a)(2) (2004).

243. *See* Steinman v. Hicks, 352 F.3d 1101, 1106 (7th Cir. 2003) (positing that while "in the ESOP context where there is no duty to diversify . . . [t]here is still a duty of prudence").

244. *See id.*

245. ERISA specifically mandates that the duty of prudence excludes any diversification aspects in the EIAP context. *See* 29 U.S.C. § 1104(a)(2). Accordingly, courts repeatedly state that any claims of fiduciary breach sounding in the failure to diversify absent extraordinary circumstances do not constitute causes of action under ERISA. *See* Moench v. Robertson, 62 F.3d 553, 572 (3d Cir. 1995); Kuper v. Iovenko, 66 F.3d 1447, 1460 (6th Cir. 1995); Wright v. Or. Metallurgical Corp., 222 F. Supp. 2d 1224, 1233-34 (D. Or. 2002) (denying plaintiffs relief where no allegations of "unusual circumstances that would give rise to an exception to the general rule that an ESOP fiduciary's decision to hold employer stock is consistent with ERISA's prudence requirement").

Likewise, traditional EIAP 401(k) program plaintiffs also find that the limited duty to diversify bars recovery absent extraordinary circumstances.[246]

b. The Vigorous Dissent in Great-West Life & Annuity Insurance Company v. Knudson *Demonstrates the Ostensible Contradiction between the Judiciary's Narrow Reading of ERISA and Its Underlying Purposes and Policies*

Courts interpret the general ERISA enforcement provisions strictly as well, ironically again citing deference to "congressional intent."[247] That the judiciary has held such intent to limit ERISA to the expressly enumerated causes of action is clearly evinced by the "carefully crafted and detailed enforcement scheme."[248] The Supreme Court in *Great-West Life & Annuity Insurance Company v. Knudson* recently stated that it is fairly clear that "'Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly,'"[249] a pronouncement that will effectively prohibit any expansive judicial interpretations of the ERISA causes of action.

But the Court only so stated by a narrow five-to-four margin, with Justices Ginsburg and Stevens drafting dissenting opinions rejecting the argument that Congress specifically intended to limit, rather than expand, the remedies under ERISA.[250] Justice Stevens remarked that expansive interpretation "accomplishes Congress's goal of providing a federal remedy for violations of the terms of plans covered by ERISA" and that "[c]ontrary to the Court's current reluctance to conclude that wrongs should be remedied, . . . the historical presumption favoring the provision of remedies for violations of federal rights should inform our construction of the remedial provisions of federal statutes."[251] Instead, "where federally-protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief."[252]

The contradiction is clear. On the one hand "the legislative history of ERISA indicates that the avenues of relief and the right of action afforded pension plan participants should be *generously construed*"[253] while other

246. *See Steinman*, 352 F.3d at 1106; *Penn. Fed'n*, 2004 U.S. Dist. LEXIS 1987, at *22.

247. *See, e.g.*, Great-West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204, 209 (2002).

248. Mertens v. Hewitt Assoc., 508 U.S. 248, 251, 254 (1993) (citing Mass. Mutual Life Ins. Co. v. Russell, 473 U.S. 134, 146-47 (1985) and strictly construing the term "equitable relief" under 29 U.S.C. § 1132(a)(3)). *See Great-West*, 534 U.S. at 209.

249. *See Great-West*, 534 U.S. at 209 (citing *Mass. Mutual Life Ins. Co.*, 473 U.S. at 146-47).

250. *Great-West*, 534 U.S. at 221 (Stevens, J., dissenting); *id.* at 224 (Ginsburg, J., dissenting).

251. *Id.* at 222 & n.2 (Stevens, J., dissenting) (citing Correctional Servs. Corp. v. Malesko, 534 U.S. 61 (2001) (Stevens, J., dissenting)), Alexander v. Sandoval, 532 U.S. 275, 294-97 (2001) (Stevens, J., dissenting) and Bivens v. Six Unknown Federal Narcotics Agents, 403 U.S. 388, 392 (1971)).

252. Bivens v. Six Unknown Federal Narcotics Agents, 403 U.S. 388, 392 (1971) (citing to Bell v. Hood, 327 U.S. 678, 684 (1946)).

253. Foltz v. U.S. News & World Report, Inc., 613 F. Supp. 634, 639 (D.D.C. 1985) (emphasis added).

statutory pronouncements and the judiciary, through the Supreme Court decision in *Great-West*[254] and prior rulings,[255] have instead imposed a contrary intention to *limit* the avenues of relief for ERISA participants. And, with the recent employee losses brought on by the conduct of Enron and WorldCom fiduciaries, the time has clearly arrived to expand the statutory causes of action in ERISA, whether through court interpretation or legislative change.

V. SARBANES-OXLEY AND THE MOVEMENT TOWARD REFORM: CHANGES IN FEDERAL LAW RELEVANT TO EMPLOYEE STOCK OWNERSHIP AND PENSION PROGRAMS

In 2002, Congress quickly reacted to the Enron and WorldCom fallout by passing the Sarbanes-Oxley Act, a move designed to impose greater liability and standards of care on corporations and their officers with regards to their securities.[256] First and foremost, Sarbanes-Oxley imposes the first major overhaul of corporate accounting and financial disclosure, setting forth new rules and requirements such as the establishment of the Public Company Accounting Oversight Board[257] and director certification of financial reports[258] to better regulate and supervise the public securities

254. *Great-West*, 534 U.S. at 209.

255. *See* Mass. Mutual Life Ins. Co. v. Russell, 473 U.S. 134, 146-47 (1985) (prohibiting extra-contractual or punitive damages in ERISA causes of action on the grounds that Congress did not expressly authorize such awards).

256. *Id.* The first page of the Act states that it is "[a]n Act to protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes." *Id.* Senator Sarbanes stated that the Act serves to "address systemic and structural weaknesses . . . revealed in . . . a breakdown in corporate financial . . . responsibility." 148 CONG. REC. S6327-06 (daily ed. July 8, 2002) (statement of Sen. Sarbanes).

257. Sarbanes-Oxley Act § 101, codified as 15 U.S.C. § 7211.

258. Sarbanes-Oxley Act § 302, 15 U.S.C. § 7241 (2004). The officer must certify that he has reviewed the report and that based on his knowledge the reports do not contain any material misstatements and provide a good representation of the company's true financial condition. *Id.* Furthermore, the officers must take responsibility for establishing internal controls and disclosing material financial information to other officers. *Id.* The Act also imposes criminal sanctions for signing off on any knowing violations included in the reports. Sarbanes-Oxley Act § 906(a) (codified as 18 U.S.C. § 1350). The new section specifically states that

> (a) Each periodic report [i.e., SEC filing] containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.
>
> (b) The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.
>
> (c) Whoever

market. Additionally, the Act, through its Title VIII,[259] added new deterrents to fraudulent activity, such as criminal penalties for altering documents,[260] defrauding shareholders of publicly-traded companies,[261] as well as enhanced penalties for acting in violation of ERISA[262] and the 1934 Securities Exchange Act.[263]

But the question remains whether the Sarbanes-Oxley Act constitutes an effective solution to aid the unnecessary losses by *pension plans* and other *employee* investments in employer stock. The likely answer is "no" for several reasons. While the Act somewhat facilitates recovery in pure securities actions, such as through eliminating bankruptcy discharge of debts

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> (1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $1,000,000 or imprisoned not more than 10 years, or both; or
> (2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.

Id.

259. The "Corporate and Criminal Fraud Accountability Act," or Title VIII of the Sarbanes-Oxley Act, serves

> to provide for criminal prosecution and enhanced penalties of persons who defraud investors in publicly traded securities or alter or destroy evidence in certain Federal investigations, to disallow debts incurred in violation of securities fraud laws from being discharged in bankruptcy, to protect whistleblowers who report fraud against retaliation by their employers, and other purposes.

S. REP. NO. 107-146, at 2 (2002).

260. Sarbanes-Oxley Act § 802. The Act adds criminal penalties to an accountant, such as Arthur Andersen, who

> knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title [Title 18—criminal penalties], imprisoned not more than 20 years, or both.

18 U.S.C. § 1519 (2004). The Act further adds penalties for the destruction of corporate audit records as well. *See* 18 U.S.C. § 1520 (2004) (as amended by the Sarbanes-Oxley Act of 2002).

261. Sarbanes-Oxley Act § 807. The relevant addition to 18 U.S.C. § 1348 imposes criminal penalties on

> Whoever knowingly executes, or attempts to execute, a scheme or artifice—
> (1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 78*l*) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78*o*(d); or
> (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l* or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78*o*(d)).

Id.

262. Sarbanes-Oxley Act § 904 (amending 29 U.S.C. § 1131). Sarbanes-Oxley greatly amplifies the penalties imposed for violating fiduciary duties under ERISA.

263. Sarbanes-Oxley Act § 1106 (amending 15 U.S.C. § 78ff(a)). The new penalties are significantly higher, both in fine amounts and potential years imprisoned, for any violations of the Securities Exchange Act.

incurred as a result of securities law violations,[264] the Act fails to impact the employee stockholder context on the whole in any meaningful or consistent way. Instead, the Act leaves plenty of room for subsequent legislative activity and interpretation to come to the aid of all EIAP employee stockholders.

A. Sarbanes-Oxley Prescribed a Bright-Line Rule that Debts Incurred in Securities Violations Are Not Dischargeable in Bankruptcy but Did Not Prescribe a Parallel Provision for Breaches of ERISA Fiduciary Duties

Sarbanes-Oxley provides relief to *securities* fraud victims attempting to secure their rights as creditors in the defendants' bankruptcy proceedings, an amendment covering only a limited number of employee investors.[265] The Act provides in relevant part that debts are not dischargeable that

> (A) [are] for
>
> (i) the violation of any of the Federal securities laws (as that term is defined in section 3(a)(47) of the Securities Exchange Act of 1934),[266] any of the State securities laws, or any regulation or order issued under such Federal or State securities laws; or
>
> (ii) common law fraud, deceit, or manipulation in connection with the purchase or sale of any security; and
>
> (B) results from—
>
> (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
>
> (ii) any settlement agreement entered into by the debtor; or
>
> (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement

264. Sarbanes-Oxley Act § 803 (adding subsection (19) to 11 U.S.C. § 523(a)). *See also infra* Part V-A.

265. Sarbanes-Oxley Act § 803 (adding subsection (19) to 11 U.S.C. § 523(a)).

266. "Securities laws" are defined in section 3(a)(47) of the Securities Exchange Act to include both the 1933 and 1934 Securities Acts, the Public Utility Holding Company Act, the Trust Indenture Act, the Investment Advisers Act, and the Securities Investor Protection Act. *In re* Gibbons, 289 B.R. 588, 592 n.6 (Bankr. S.D.N.Y. 2003).

payment, attorney fee, cost, or other payment owed by the debtor.[267]

"The section, by its terms, applies to both statutory claims under the securities laws and common law fraud, so long as it arises in connection with the purchase or sale of a security."[268] Congress closed the "loophole" in the bankruptcy code that sometimes allowed "wrongdoers to discharge their obligations under court judgments or settlements based on securities fraud and other securities violations."[269] Moreover, section 308(a)'s "fair funds" rule affords further relief to victims of securities violations by overriding bankruptcy code priorities and effectively redistributing the issuer's assets to the shareholders as unsecured creditors, much like tort claimants.[270] The new laws also serve to help avoid re-litigation of securities fraud claims in bankruptcy court by imposing a bright-line rule regarding the preclusive effect of prior court judgments and settlements.[271] Additionally, bankruptcy courts have already decided that the Act's provisions should apply retroactively.[272]

But the improvements in protections afforded to securities purchasers clearly does not apply equally to all employee investors. Section 523(a)(4), left unaltered by Sarbanes-Oxley, governs debts arising from a breach of fiduciary duty, such as under ERISA.[273] Section 523(a)(4) requires that the plaintiff show "(1) the existence of either an express or technical trust; (2) the status of being a fiduciary of such a trust; and (3) fraud or defalcation while acting in the capacity of a fiduciary of such a trust."[274] Such statutory requirements essentially amount to forced re-litigation of the prior ERISA proceedings in order to protect creditor status, [275] as the "defalcation" and "fraud" definitions under bankruptcy common law interpretation may in fact vary from the conduct constituting the substantive claim.[276] Thus, unlike in the securities law context, Sarbanes-Oxley failed to provide the same

267. 11 U.S.C. § 523(19) (2004).

268. *In re Gibbons*, 289 B.R. at 592.

269. S. REP. NO. 107-146, at 10 (2002).

270. Sarbanes-Oxley Act § 308(a) (codified at 15 U.S.C. § 7246(a)). Both civil penalties and disgorged profits are recoverable from violators and become part of a "disgorgement fund" for injured shareholders. *See generally* Douglas A. Henry, Comment, *Subordinating Subordination: WorldCom and the Effect of Sarbanes-Oxley's Fair Funds Provision on Distributions in Bankruptcy*, 21 BANK. DEV. J. 259 (2004).

271. S. REP. NO. 107-146, at 10 (2002); *see also Gibbons*, 289 B.R. at 592-95 (detailing Congressional intent in ruling on the retroactivity of the Sarbanes-Oxley provisions).

272. *In re Gibbons*, 289 B.R. at 594-97 (finding that section 523(a)(19) should be applied in existing bankruptcy proceedings given a "section-by-section" analysis of Congressional intent under the test set forth in *Landgraf v. USI Film Prods.*, 511 U.S. 244, 268 (1994)).

273. *See* 11 U.S.C. § 523(a)(4) (2004).

274. *In re* Eisenberg, 189 B.R. 725, 730 (Bankr. E.D. Wis. 1995).

275. *See id.* (demonstrating that a court necessarily must reexamine the merits of a plaintiff's ERISA claim in ruling on a section 523(a)(4) creditor cause of action).

276. *Id.* (stating that the plaintiff must show that the defendant "breached his fiduciary duties through an act of defalcation, and [that] the debt arose on account of such breach" despite the fact that the plaintiff had already proved breach of the duty to provide complete and accurate plan information upon request and the resulting loss in a prior civil action).

conclusive remedy against any ERISA fiduciaries filing for bankruptcy, instead necessitating that plan participants still reprove their cases in filing their creditors claims and likely producing inconsistent results[277] between groups of employee investors.

B. Sarbanes-Oxley Focuses Too Heavily on Prevention as Opposed to More Expansive Avenues to Recover Losses Actually Sustained

Additionally, Sarbanes-Oxley may in fact cause a repeat performance of the recent scandals, necessitating the adoption of more courses of *redress*, not just prevention. One renowned commentator, William Niskanen of the Cato Institute, posits that Sarbanes-Oxley will in fact produce dishonesty among chief executive officers because the Act mandates personal certification and affirmation of SEC filings, a time-intensive undertaking which Niskanen believes "leads to risk aversion or lies."[278] "Sarbanes-Oxley is clearly necessary but it's partly harmful and clearly insufficient."[279] "'What the stock exchange and government has done is accept prescriptions of the corporate reform movement without evidence, and that gives people a false sense of security that something has happened. . . . [Sarbanes-Oxley] will have zero effect.'"[280]

Moreover, Sarbanes-Oxley does not adequately address the need for further controls over and redress for the conduct and decision-making of program fiduciaries. While a much-needed step in the process of reform, the legislative effort falls short of what is truly required to regain employee investor confidence and effectively regulate the administration of employee pension funds and other investment programs primarily based on the acquisition of employer stock. Sarbanes-Oxley mirrors the purposes and goals of the Regulation Fair Disclosure[281] established before the wake of corporate implosions, focusing on "stop[ping] conflicts of interest inside firms."[282] However, that is "not the main game . . . [and] [t]he rules should

277. *Compare In re* Whitcomb, 303 B.R. 806, 809-10 (Bankr. N.D. Ill. 2004) (exemplifying the ease with which Sarbanes-Oxley disposes of bankruptcy creditors' claims resulting from securities fraud judgments), *and Gibbons*, 289 B.R. at 594-97, *with Eisenberg*, 189 B.R. at 730 (demonstrating the reproving of the ERISA claims already adjudicated), *and* Eavenson v. Ramey, 243 B.R. 160, 164-65 (N.D. Ga. 1999) (demonstrating the reproving of the ERISA claims already adjudicated).

278. *See* Sean Aylmer, *Governed by Fear*, AUSTRL. FIN. REV., Nov. 3, 2003, at 68 [hereinafter *Governed by Fear*] (quoting Cato Institute Chairman William Niskanen).

279. *Id.* (quoting Cato Institute Chairman William Niskanen).

280. *Id.* (quoting Cato Institute Chairman William Niskanen). Niskanen fears that "investors and bankers will think they [corporations] are doing enough to meet community corporate governance standards by following the new rules . . . [b]ut they need to do more." *Id.*

281. *Id.*

282. *Id.*

be about shareholders getting the best return."[283] Accordingly, Sarbanes-Oxley should have concentrated more on helping shareholders actually maximize results and protections and less on simply requiring rote, ministerial statements to purportedly maintain control over corporate actions.[284]

C. Certain Groups of Employee Investors Still Have No Means of Redress

Sarbanes-Oxley still fails to account for certain groups of employee investors and does not fully cover all major potential causes of action against companies and the individuals comprising the corporation's governing body. The legislature should have attempted to account for the interests of holders of other deferred compensation plans not covered by ERISA or securities laws, such as bonus stock and phantom stock plans, who also fell victim to the fraudulent activities in the recent cases. Bonus plans and "phantom stock" compensation have been excluded from the federal securities laws causes of action.[285] Those plaintiffs can potentially bring state law causes of action for securities fraud, but are not entitled to take part in the consolidated, streamlined federal proceedings currently underway.[286] Thus arguably, at the very least, phantom stock and the other employer stock ownership interests falling without the protections of ERISA or securities laws should warrant application of at least one of the statutory schemes to provide some relief to the employees whose accounts were obliterated.[287] While some may view the "phantom stock" and other stock bonus programs as entirely outside the purview of either ERISA or securities laws,[288] the reality exists that those plans constitute a part of an employee's compensation package in one way or another, and thus should be afforded some level of protection against fraudulent conduct. Nothing in the Act covers such losses suffered: it simply modifies the regulations and remedies pertaining to existing classes of programs.

D. Where ERISA Should Apply Concomitantly with Securities Laws so that All Employee Investors Are Entitled to the Same Heightened Levels of Protection

For one, Congress should have amended its laws and regulations to more vigorously emphasize the importance of ensuring that pension fiduciaries truly take all appropriate measures to diversify plan investments, even outside of employer stock, because "employee-ownership makes an employee's portfolio even less diversified as [it] compound[s] . . . lack of

283. *Id.*

284. *Id.*

285. *See In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 636 n.123 (S.D. Tex. 2003).

286. *See id.*

287. *See generally* Bodie, *supra* note 15, at 599.

288. *See In re Enron*, 284 F. Supp. 2d at 636 n.123.

diversification by investing both human capital and financial capital, whether through direct contributions or sacrificing pay and benefits, in the same corporation."[289] The laws regulating the pension plan lockdowns that caused so much of the disaster at Enron certainly help avoid a certain degree of problems with undiversified investments,[290] but the fact remains that establishing any claim for breach of fiduciary duty under the *Moench* abuse of discretion standard presents an often insurmountable hurdle for plaintiffs to prove.[291]

If altering fiduciary standards is too drastic, at the very least Congress should enact the pending proposal to require notice to participants where plan assets are heavily invested in employer securities.[292] Senator Evan Bayh introduced a bill on November 19, 2003 which would add a subsection to the existing ERISA mandates under 29 U.S.C. § 1025.[293] The addition would compel plan administrators to "include in the account statement a *notice that the account may be overinvested in employer securities*" where over fifty percent of plan assets are invested in employer stock or other securities.[294] The proposed amendment would serve to "provide information and advice to pension plan participants to assist them in making decisions regarding the investment of their pension plan assets, and for other purposes."[295] The changes would not apply to an ESOP to the extent that it does not include any 401(k) contributions, [296] meaning that pension-directed account holders would be offered an element of needed statutory protection especially where many plan agreements still rely significantly on employer stock investments. Congress therefore has taken another small step towards reform but should also seriously contemplate comparable further action to aid employee investors.

Furthermore, corporate leaders should not avoid liability for material misstatements made in private as opposed to the public at large that nonetheless induce detrimental investor purchases. CEOs have perpetrated huge frauds by virtue of their superior positions within the company. For instance, plaintiffs have so far successfully alleged that Bernard Ebbers, the WorldCom CEO during the relevant class period, knew of the crooked accounting methods and the actual financial health of the company and

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289. Blum, *supra* note 38, at 1554; *see also Governed by Fear*, *supra* note 278 (illustrating the needs of corporate shareholders through a mutual fund example, calling for corporate governance rules to promote better approaches to maximizing returns for shareholders instead of merely mandating compliance).

290. *See* Sarbanes-Oxley Act § 306; *see also supra* notes 236-40 and accompanying text.

291. *See supra* notes 236-40 and accompanying text.

292. *See* S. 1892, 108th Cong. (2003).

293. *Id.*

294. *Id.*

295. *Id.*

296. *Id.*

authorized the improper statements, as he had millions of dollars to gain by perpetrating the alleged scheme.[297] Andrew Fastow, the ex-chief financial officer of Enron, has pleaded guilty to two counts of fraud and has likely implicated recently-indicted Kenneth Lay and Jeffrey Skilling, both former chief executive officers.[298] Worse, corporations' fraudulent activities often wind their paths through investment banks and other outside analysts and auditors who effectively aid and authorize the schemes in pursuit of personal gain.[299] Investment banks and analysts are "in the business of speaking to the public about stock values" and face liability for misstatements.[300] The securities acts thus provide ample avenues to recovery, but unfortunately the majority of employee shareholders will profit from few, if any, of the methods of relief, as ERISA does not contain comparable provisions.

Certainly, individuals accused of various fraudulent activities leading to depletion of employee investment accounts would prefer to argue for the preemption of one statutory scheme over the other where the alleged conduct implicates multiple causes of action. Defendants in the various litigations combining alleged securities and ERISA causes of action have attempted to argue that ERISA should not apply in cases involving the dissemination of false or misleading SEC filings in violation of securities laws.[301] Most courts do not accept the defense that securities rules and regulations preclude fiduciaries from fulfilling their fiduciary duties where the laws "conflict."[302]

297. *In re* WorldCom Sec. Litig., 294 F. Supp. 2d 392, 416 (S.D.N.Y. 2003) (explaining how the "unique and substantial" gains Ebbers stood to profit from the scheme adequately pled scienter in defending a motion to dismiss).

298. *See* Jen Rogers, *Fastow and His Wife Plead Guilty: Ex-Enron CFO Agrees to Serve 10 Years, Cooperate with Authorities: Will Skilling and Lay Be Next?*, CNN/MONEY, Jan. 14, 2004, *available at* http://money.cnn.com/2004/01/14/news/companies/enron_fastows/index.htm?cnn=yes; Loren Steffy, *What of Lay's Claims? Answers Lie in Valhalla*, HOUS. CHRON., July 8, 2004.

299. *See In re WorldCom*, 294 F. Supp. 2d at 404-06 (describing the "symbiotic relationship" between WorldCom, its CEO Bernard Ebbers, the investment bank Salomon Smith Barney, and the supposedly independent analyst Jack Grubman). Salomon Smith Barney apparently had entered into an "illicit *quid pro quo* arrangement" with WorldCom, which perpetuated the fraud by allowing the incorrect and entirely untruthful positive reports and SEC registration statements regarding WorldCom's financial health to coax investors to purchase the securities in reliance on "reliable advice from an independent analyst [Grubman] and trustworthy brokerage house [Salomon Smith Barney]." *Id.* at 404. Enron too had close dealings with banks such as UBS Warburg, which also now faces liability from its outside investors. *See, e.g.*, Nikko Asset Mgmt. Co. v. UBS AG, 303 F. Supp. 2d 456, 457 (S.D.N.Y. 2004) (involving a suit filed by a Japanese investment company who had bought notes backed by Enron securities from the defendant investment bank).

300. *In re WorldCom*, 294 F. Supp. 2d at 428 (stating that "[t]hose who choose to speak . . . must speak honestly—not in half-truths, in bad faith, or without a reasonable basis for their statements" in explaining that the investment bank involved, Salomon Smith Barney, "spoke forcefully and frequently about the value of WorldCom" and therefore could be held liable for such statements). It must be noted as well that the injured investors must demonstrate that the misstatement caused their loss. *See* 17 C.F.R. § 240.10b5-1 (2004).

301. *See, e.g.*, Rankin v. Rots, 278 F. Supp. 2d 853, 873-78 (E.D. Mich. 2003) (discussing the WorldCom and Enron litigations and the defendants' arguments); *In re* WorldCom, Inc. ERISA Litig., 263 F. Supp. 2d 745 (S.D.N.Y. 2003) (rejecting the defendants' assertions and denying motions to dismiss); *In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 511-12 (S.D. Tex. 2003); *In re* McKesson HBOC, Inc. ERISA Litig., No. C00-20030 RMW 2002 U.S. Dist. LEXIS 19473 (N.D. Cal. Sept. 30, 2002); Hull v. Policy Mgmt. Sys. Corp., No. 3:00-778-17, 2001 U.S. Dist. LEXIS 22343, at *1 (D.S.C. Feb. 9, 2001).

302. *See, e.g.*, *Rankin*, 278 F. Supp. 2d at 873-78 (discussing the "conflict" between securities

Therefore, ERISA and securities laws do not necessarily conflict with one another, at least from the employee investor perspective in causes of action alleging fraudulent SEC filings and other material misrepresentations. And likewise, the statutory protections afforded under ERISA against similar conduct should apply equally to other employee programs utilizing deferred compensation, regardless of whether the method resembles an "investment" rather than traditional pension programs.

E. The Positive Note: Sarbanes-Oxley Imposes Equalizing "Blackout Period" Relief and Director Stock Activity Disclosure Requirements

Sarbanes-Oxley Act section 306 addressed concerns common to all employee investors by modifying both federal securities laws[303] and ERISA provisions to effectively equalize the investing playing field between regular employees and corporate executives by restricting "blackout" periods and requiring disclosure of any securities purchases or sales by officers and directors. In regards to the securities laws, section 306, codified in 15 U.S.C. § 7244 and supplemented by SEC implementation releases, prohibits the trade of employer equity securities by directors and officers during pension fund "blackouts," where "rank-and-file" employees cannot sell their individual pension account[304] company stock holdings.[305] "Blackout periods" amount to three or more business days during which the plan fiduciary or security issuer precludes half or more of the company's individual account plan participants or beneficiaries from buying, selling, or otherwise transferring interests in the company equity security.[306] Even

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laws and ERISA and deciding that the duties under the two statutory schemes "can exist concomitantly" in rejecting outright the defendants' argument); *In re WorldCom*, 263 F. Supp. 2d at 753 (rejecting the defendants' assertions and denying motions to dismiss); *In re Enron*, 284 F. Supp. 2d at 511-12; *Hull*, 2001 U.S. Dist. LEXIS 22343, at *1 (allowing the argument but dismissing on other grounds). *But cf. In re* McKesson HBOC, Inc. ERISA Litig., 2002 U.S. Dist. LEXIS 19473, at *5 (deeming defendants' argument correct in dismissing plaintiffs' claims).

303. 15 U.S.C. § 7244 (2004).

304. Individual account plans are defined under ERISA § 3(34) (codified as 29 U.S.C. § 1002(34)).

305. Sarbanes-Oxley Act section 306 (codified as 15 U.S.C. § 7244(a)(1)) provides:

> Except to the extent otherwise provided by rule of the Commission pursuant to paragraph (3) [authorizing the SEC to promulgate clarifying supplementary rules], it shall be unlawful for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer.

Id.

306. Sarbanes-Oxley Act § 306(a)(4)(A) (codified as § 7244(a)(4)(A)). The Act also enumerates certain exceptions to this general rule, such as when the blackout is "regularly scheduled," meaning "incorporated into the individual account plan" and "timely disclosed to employees."

though it was scheduled to change administrators, the blackout period in the Enron scenario amplified the losses, as the plan values "plummeted along with [the] stock price" and no regular employees could alter their investment portfolios.[307] Section 306 also provides a shareholder derivative cause of action against any executive in violation of the provision.[308] Thus Sarbanes-Oxley eliminates the inequality of investment transfer rights between ordinary employees and those at the top, as everyone alike now must forego the ability to alter the employer securities component of their investment portfolios during the blackout periods.

Furthermore, Sarbanes-Oxley even amends ERISA to require specific notice to plan participants of upcoming blackout periods. In particular, the Act mandates that the plan administrator provide at least thirty days notice[309] of the suspension[310] to plan participants and beneficiaries of individual account plans[311] absent extraordinary circumstances.[312] Plan administrators also now face civil penalties where they fail to meet the thirty-day notice requirement.[313] The Act therefore affords employee investors some form of protection from arbitrary and unexpected blackouts, which constituted a large part of the "galling" situations witnessed at Enron and Global Crossing, where employees sat and "helplessly watch[ed] the[ir] stock's value plummet[,]" unable to stop the financial hemorrhaging.[314] Sarbanes-Oxley thus also gives the employee investor the opportunity to "prepare" for

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§ 306(a)(4)(B)(i)(I)-(II). The Act also does not preclude transfers by directors or officers where the blackout is imposed for reasons of mergers, acquisitions, and other such transactions "involving the plan or plan sponsor" by which persons become or cease to be plan participants or beneficiaries. § 306(a)(4)(B)(ii).

307. ENRON: THE RISE AND FALL, *supra* note 1, at 289. The *Enron* plaintiffs have alleged as follows:

> According to the complaint, during the **lockdown**, plan participants were unable to move their investments from one plan investment fund to another despite exigent circumstances that made the **blackout** imprudent. The complaint asserts that Northern Trust [the named fiduciary] exercised authority and control over the plan assets by imposing the **lockdown**, which it had the ability to stop or delay, and that by not stopping or delaying that **lockdown**, Northern Trust breached its fiduciary duties to plan participants.

In re Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 534 n.10 (S.D. Tex. 2003).

308. 15 U.S.C. § 7244(2)(B) (2004).

309. Sarbanes-Oxley Act § 306(b)(2)(B).

310. *Id.* at § 306(b)(7). Section 306(b)(7) defines "blackout period" for ERISA purposes slightly differently from the analogous securities application under section 306(a)(4), also excluding restrictions "by reason of the application of the securities laws" and restrictions applicable to singular individual participants or beneficiaries. *Id.* at § 306(b)(7)(B)(i), (iii).

311. Sarbanes-Oxley Act § 306(b) (codified as 15 U.S.C. § 7244(b)).

312. Sarbanes-Oxley Act § 306(b)(2)(C). The thirty-day requisite notice is thus not entirely inflexible, as the Act also allows exceptions where a fiduciary determines that delaying the blackout would violate the fiduciary duties under ERISA § 404(a)(1) as well as where unanticipated events or "circumstances beyond the reasonable control of the plan administrator" render thirty-day notice impossible, as long as both exceptions are memorialized in writing by a plan fiduciary. *Id.*

313. Sarbanes-Oxley Act § 306(b)(3) (codified as 29 U.S.C. § 1132(c)(1)). The plan administrator can face up to $100 per day per participant for his failure to provide adequate notice, adding to the civil penalties under 29 U.S.C. § 1132. *Id.* at § 306(b)(3)(C) (codified as 29 U.S.C. § 1132(a)(7)).

314. *See* Bost, *supra* note 2, at 12 (describing the blackout situation generally).

the blackout in a sense by mandating thirty days notice, as the plan participant can choose to change his investment portfolio in anticipation of the freeze.[315]

Moreover, Sarbanes-Oxley also requires that directors, officers, and shareholders owning ten percent or more of the company disclose their stock sales to the Securities and Exchange Commission before the close of the second business day after the sale.[316] The provision likely serves to assist both intra-company and public investors in recognizing and reacting to any potential signals from insider transactions indicating that the stock prices may decline and thus in turn eliminate the potential for "insiders" to gain any substantial unfair advantage by selling off earlier than the rest of the market, theoretically at a higher price.

Thus, if anything, Sarbanes-Oxley supposedly instills a heightened sense of care on the part of corporate directors and officers towards all shareholders. Recent litigations "suggest that directors must take their responsibilities seriously in the post-Enron era."[317] For example, certain pending state court litigations have imposed striking restrictions on the common law "business judgment rule," which generally allows corporate fiduciaries "exculpatory" leeway in decision-making.[318] The Act has put corporations and their agents on notice that they are being watched externally and internally, and that the financial world does not want to see another Enron- or WorldCom-type event occur.

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315. *See id.*; *see also In re* Enron Corp. Secs., Derivative & ERISA Litig., 284 F. Supp. 2d 511, 534 & n.10 (S.D. Tex. 2003) (describing generally the lockdown situation and detailing how the employees wanted to transfer out of the Enron stock but could not).

316. Sarbanes-Oxley Act § 403 (codified as 15 U.S.C. § 78p(a)(1)-(4)); *see also* Bost, *supra* note 2, at 18 (calling the change from ten days to two days a "drastic shortening").

317. Robert Reder & Scott Edelman, *Courts Turn Up Corporate Heat: Recent Judicial Developments Impacting Corporate Governance and Director Liability*, THE CORPORATE COUNSELLOR, Sept. 12, 2003, at 1 (hereinafter *Courts Turn Up Corporate Heat*).

318. *See id.* (citing *In re* Walt Disney Co. Derivative Litigation, No. 15452, U.S. Dist. (D. Del. May 28, 2003), *In re* Abbott Laboratories Derivative Shareholders Litigation, 325 F.3d 795 (7th Cir. 2003), and Pereira v. Cogan, 294 B.R. 449 (S.D.N.Y. 2003), as "potentially limit[ing] the scope of the protections provided to directors by the business judgment rule, as well as the protections afforded by 'exculpatory' provisions that are expressly provided for by state corporate statutes in order to shield directors from liability for breaches of their duty of care"). The courts in the cited cases have all imposed more stringent requirements on the fiduciary duties of corporate directors, theoretically to reflect Congress and the policies of Sarbanes-Oxley. *Id.* ("[T]hese cases signal that directors will not be shielded from liability by exculpatory charter clauses where it can be demonstrated that they have consciously disregarded their duties . . . [and] [t]he message is really rather simple: the job of the corporate director is . . . to safeguard the interests of the shareholders . . . .").

VI. WIDER IMPACT— THE POST-SCANDAL LANDSCAPE AND THE OUTLOOK FOR THE EMPLOYEE INVESTMENT FUTURE

A. *Psychology of the Market: Why Employee Investors Will Still Need Protections to Safeguard Their Futures in the Post-Enron Era*

Taking the "preemptive strike" approach such as Sarbanes-Oxley, discovering and correcting the cause of the recent corporate scandals may aid averting further economic destruction. Understanding the labor and employment environment as well as the financial landscape may provide more valuable insight into why the events of 2001-2002 occurred and thus why they may happen again, necessitating a more comprehensive system of protection for EIAP participants.

1. Are Public Investors Putting Too Much Pressure on Corporations to "Perform," Leaving Employee Investors to Bear the Burden?

Without a doubt, the enormous gains seen at Enron, WorldCom, Global Crossing, and others in their heydays gave investors, both employee and public, a taste of sky-high returns and dreams (and often realities) of great wealth.[319] Stocks would double, even triple and quadruple in short time, and investors were happy.[320] Employees were increasingly becoming significant shareholders, literally "buying into" the craze and the incredible successes of the companies which they were helping to build. But such prosperity bred pressure to continue to perform, and likely promulgated the insatiable need for higher returns that characterized the pre-collapse era.

Such pressure may reappear in the near future, however, as companies and their employees feel pressured to regain the "status" and prosperity they rode during the late 1990's, when the technology sector was in full swing and pre-Enron. Accordingly, the post-September 11 market fallouts may in fact exacerbate the situation, as corporations struggle to get back on their feet and attain once more the successes of the last decade. In turn, such an environment seems ripe for inappropriate, even desperate, conduct on the part of corporations to regain the confidence of public investors and achieve even higher returns. At the very least, corporations also may opt not to maintain ESOPs and other stock programs falling within the ambit of the securities laws for fear of heightened liability, as opposed to traditional ERISA plans. In any case, the employees will once again bear the burden, through the continued lack of adequate civil remedies and potentially with restricted investment choices.

319. *See generally* ANATOMY OF GREED, *supra* note 218.

320. *Id.*

2. Or Are Directors Simply Greedy?

Undisputedly, the corporate world changed forever in October 2001. It cannot be denied that the investor of today, whether public or employee, is not the same person with the same confidence and vigor of the pre-Enron investor.[321]

> Think back to one year ago [September 2001]. Think of all that has occurred since 9/11/01 in the financial markets, in corporate America, in your own portfolio. That is how the end of an awesome innocence looks. . . [T]he euphoria that characterized investing in the late 1990's is gone; that wide-eyed acceptance of every word corporate executives uttered, of every financial statement they released, of every outlandish projection an analyst made has been replaced by a sense that trust must once again be earned, that skepticism is a worthy trait, that the advice of analysts can be costly.[322]

Undoubtedly, American employee investors, like their public marketplace counterparts, have not felt the same since the demise of Enron and its contemporaries.[323] Employee investors suffered arguably worse losses as a result of the collapses, as they had invested not only financial and emotional resources into their companies but thus also had "proudly" placed their futures in the supposedly trustworthy hands of their employers,[324] only to witness everything disappear before their eyes. It is one thing to lose a financial investment, almost like a gamble in black-jack or roulette, but it is an entirely different story where entire livelihoods and emotional investments vanish unexpectedly in a matter of days, leaving hard work and dedication amounting to nothing in the end.[325]

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321. Gretchen Morgenson, *Market Watch: Rebound from Ruin, If Not from Distrust*, N.Y. TIMES, Sept. 8, 2002, at 3 [hereinafter *Rebound from Ruin*].

322. *Id.* (deploring the lost sense of trust while congratulating investors for learning from the mistakes and continuing their push to recover from scandal and September 11). "At the same time that all Americans were forced to confront the fact of their country's vulnerability, investors were also made to understand how much about the markets and the companies they owned had been illusory in recent years." *Id.*

323. *See* Hill v. BellSouth Corp., 313 F. Supp. 2d 1361, 1368 (N.D. Ga. 2004) (stating that "the markets are more unwilling than ever to tolerate corporate misstatements of earnings" in a case involving restatements of results of investments in Latin America).

324. ENRON: THE RISE AND FALL, *supra* note 1, at 290 ("Enron's active touting of own stock to its own workforce apparently worked. Employees who were filled with pride about working for Enron also proudly invested 401(k) money in Enron's stock. . . . [As one employee stated:] 'They were always talking about the stock price . . . [and] always said the stock was undervalued.'"); *see also* Blum, *supra* note 38, at 1549 (distinguishing the employee-investor risk as one of "human capital" as opposed to financial stakes).

325. One columnist harshly summed up the circumstances: "In a matter of months, a bad crop of

The nature of these recent scandals took the corporate world by surprise as well, with a markedly more insipid and seemingly widespread character than any prior situation. Wall Street and the securities marketplace have witnessed financial implosions in the past. For one, Wall Street firms crumbled in the 1970's due to "technological incompetence and lack of capital."[326] And the 1980's saw plenty of greed and the implosion of firms such as Drexel Burnham Lambert in addition to the Savings and Loan scandal.[327] But the recent debacles have caused clearly more marked disasters for investor confidence.[328] As world-renowned financier Felix Rohatyn stated, the previous collapses "didn't cost 50,000 jobs, people's savings and a decline in market value of trillions of dollars . . . [t]his [situation] is not about a bunch of rogue C.E.O.s."[329] And worse, it even seems that the alarming epidemic spread still, even overseas, as Europe's Parmalat now stands under investigation for the "disappearance" of 10 billion Euros, earning the Italian giant the nickname "Europe's Enron."[330] The corporate world has seemingly been orchestrating a con scheme that dwarfs even the most infamous of past frauds, this time tapping into and stealing from the very human resources that drive their success.

B. *Effects on the Already-Struggling Economy: Why the Merely Preventive Measures of Sarbanes-Oxley May Do More Harm than Good at this Juncture*

On a related note, another major concern regards the economic effects that the Sarbanes-Oxley Act and any further legislation may have on corporate risk in the current down economy, a fact which in turn will stifle any financial gains to existing pension and stock funds. The provisions of the Sarbanes-Oxley Act resulting from the Enron and WorldCom debacles

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U.S. corporate executives incinerated trillions of dollars in wealth and destroyed the lives of thousands of innocent employees." *Pinstripes to Prison Stripes*, L.A. TIMES, Jan. 16, 2004, at B-14.

326. *Rebound from Ruin*, *supra* note 321.

327. *See id.*

328. *Id.* (citing notable financier Felix Rohatyn and calling the Enron and WorldCom legacies a "greater and longer-lasting impact on the economy" than previous scandals because they involved "venerable financial institutions . . . at the heart of the . . . debacles").

329. *Id.* Morgenson actually describes the root of the problem as a risk "from within our shores, not without[,] . . . emanat[ing] from the people in positions of power at corporations who cheat their shareholders, lie to investors and make millions in outsized compensation or well-timed stock sales just before their games are exposed." *Id.*

330. Deborah Hargreaves, *Market Insight: Impact of 'Europe's Enron' Pales Next to the Original*, THE FIN. TIMES, Jan. 7, 2004, at 44. The silver lining in the new scandal in Italy is that "investors have been under few illusions about Italian companies" unlike the traditional trust in American corporate governance that caught so many people off guard with the fall of the giants here in the U.S. *Id.* Apparently Parmalat is not alone either. Royal Dutch/Shell Group recently disclosed that it had "overstated proven energy reserves by 20 percent" and the Swiss giant Adecco appears to be currently "unraveling" under allegations of improper bookkeeping. *An Enron Plea That Reverberates*, WASH. POST, Jan. 18, 2004, at F2 (calling the recent European scandals the "Chapter 2" to Enron's "first chapter in the corporate scandal saga"); *see also In re* Royal Ahold N.V. Secs. & ERISA Litig., 219 F.R.D. 343, 343 (D. Md. 2003) (involving another Dutch company initially restating its earnings by over $500 million and misstating its losses by almost $2 billion).

have placed markedly "heightened duties" on companies, their management, directors, and audit committee members and thus "enhanced exposure to risk in the post-Enron climate."[331] In turn, the economy will take longer to pick up, as capital spending remains "muted," a likely result of the new aversion to risk taking post-Sarbanes-Oxley enactment into law.[332] Sarbanes-Oxley thus may in fact hinder corporate investment by its more stringent regulations and therefore slow the road to economic recovery, still chilling the success of employee savings and investment programs.[333] Pension plans on the whole have suffered in the past few years due to the stock market slump in addition to the dollar's weak position,[334] and at this point in time the Act will not ameliorate the financial situation.

Moreover, the legislation is slow to work, especially given poor economic timing, and will provide smaller returns. As one analyst sarcastically stated, despite the potential drawbacks of audit and other controls that seem to draw out the economic stagnation, "[t]he payback is a better functioning capital market. It's much better than just rolling the dice."[335] Sarbanes-Oxley will likely procure "more secure investments for shareholders but lower returns,"[336] a mixed-blessing for the ESOP participants but to no avail for other EIAP participants. In the end, Sarbanes-Oxley provides a step toward reaching much-needed reform for employee investment programs, but it in no way delivers all of the adjustments necessary to creating a safer, more successful environment for employee deferred compensation plans. Courts have already lobbed the ball

331. Raphael Grunfeld, *Who Wants to Be on the Audit Committee? Sarbanes-Oxley Imposes Heightened Duties While Clearly Delineating Parameters*, N.Y. L. J. (May 5, 2003) (positing that audit committees post-Sarbanes-Oxley will indeed exercise more control over corporations and their directors and hopefully aid in the protection of investors but will in turn face significantly increased personal liabilities).

332. *See Governed by Fear*, *supra* note 278, at 68.

333. *Id.* As stated by one expert, Sarbanes-Oxley has caused unnecessary delays in economic recovery because it engendered "reluctance [in] managements to take the risks and make the investments that had previously brought the economy roaring back from periods of stagnation or recession." *Id.*

334. *Pension Assets Climb to $14.2 Trillion Worldwide; Last Year's Gains Did Not Close Deficits a Report Says a Full Recovery may Be Several Years Away*, L.A. TIMES, Jan. 20, 2004, at C3. One analyst said, "'The damage to global pension funds has been severe' . . . [and] '[r]ecovery to full funding levels is very likely to be several years off.'" *Id.* (quoting head of Watson Wyatt's global investment practice, Roger Urwin, explaining the current pension fund market).

335. *See Governed by Fear*, *supra* note 278 (quoting a PricewaterhouseCoopers analyst who believes that those who believe that Sarbanes-Oxley's requirements may be "costly" neglect the benefit of "less risk to the investors").

336. *Id.* (quoting an analyst who stated that investors habituated to giant returns will have to adapt to the lower rates of the new era).

to Congress, who must now pick it up from the net and serve it back with added reforms.[337]

VII. CONCLUSION

After all the smoke has cleared, employee investors from the imploded corporations must simply sit back and wait to see what restitution they can recover from the bankrupt companies, if anything at all. Ongoing criminal investigations and guilty pleas of key corporate officers and directors responsible for the mayhem only add to the tragic nature of the situation, as yet more lives and families are destroyed.[338] Some feel frustration over the seemingly inconsistent standards in securities fraud proceedings, as many top executives have yet to face criminal charges, leaving the employees still without some vindication.[339] Moreover, the employees do not have a true light at the end of the tunnel to recovery at this point in time. Criminal investigations and trials provide some solace,[340] but the fact remains that the employees stand low on the priority list of creditors and claimants, with only the hopes that they will regain a fraction of what they lost in any settlement.[341]

In the end, the road to recovery is long and remains to be seen. While Sarbanes-Oxley may work to prevent future scandal and investor losses,[342] "the damage to investor confidence has been done"[343] and is not likely to recover anytime in the near future. Moreover, the employee investor, a creature built on the idea of promoting loyalty and incentive to work harder through ownership in an entity, may never fully regain the trust in the corporation and its governance, thereby eviscerating the very purpose and inspiration to the theory behind employee ownership programs in the first

337. *See* S. 1892, 108th Cong. (2003) (calling for mandatory disclosure under ERISA where savings plans invest more than fifty percent of plan assets in the employer's securities).

338. *An Enron Plea That Reverberates*, *supra* note 330 (describing Andrew and Lea Fastow's guilty pleas entered so as to avoid simultaneous sentences and allow at least one parent to stay at home with their young children).

339. *The Bigger They Are (The less likely are they to fall)*, Editorial, N.J. L. J. (Aug. 25, 2003) (articulating the frustration with the fact that the chief executives and top banks involved in the Enron and WorldCom scandals have yet to face any criminal penalties while Martha Stewart, who fraudulently obtained only $40K, is prosecuted).

340. *An Enron Plea That Reverberates*, *supra* note 330 (remarking that by confessing to "collu[sion] with 'members of Enron's senior management,'" Andrew Fastow's guilty plea "signal[ed] a hunt drawing to its conclusion," in reference to the likelihood that Fastow's proffered information will implicate Kenneth Lay and Jeffrey Skilling).

341. Mary Flood, *The Fall of Enron: Recovery Is Closer for Retirement Cash*, HOUSTON CHRONICLE, May 21, 2004, at 9B; Purva Patel, *Judge Gives Preliminary Approval to Enron Settlement Deal*, HOUSTON CHRONICLE, Feb. 5, 2005, *available at* http://www.chron.com/cs/CDA/ssistory.mpl/special/enron/3025289 (last visited Feb. 28, 2005) (outlining the proposed settlement); *see also* Ben White, Directors Run Risk of Paying Penalties Out of Their Pockets, WASH. POST, Jan. 20, 2005, at E1 (discussing the impact of settlements in Enron and WorldCom).

342. *See* Floyd Norris, *Still Another Accounting Scandal, but With a Difference*, N.Y. TIMES, Jan. 17, 2004, at C1 (positing that the Sarbanes-Oxley Act should work to avoid a "new breed" of accounting problems, namely those where company management keeps corporate disclosures inadequate and thus conceals true financial status).

343. *Id.*

place. While Congress has attempted to ameliorate some concerns, it has not gone far enough to remedy the destruction that has taken place. Instead, the corporate world will have to redeem itself in the eyes of its workforce only by proving that the recent fraudulent acts of the various giants such as Enron, WorldCom, Adelphia, and others were no more than the singular and isolated conduct of a few individuals and not the products of a systemic scheme to leave unrewarded the very human capital and skill that produced the profitable basis upon which the directors launched their frauds. No longer will employees blindly put their money into a company, believing without question that their financial interests will necessarily be adequately protected by the company or its directors, instead holding predisposed suspicions that the entity seeks to profit at their expense and worrying that they may have no means of recovering such losses. Thus, Enron and its contemporaries marked the end of an "awesome innocence"[344] in employee investments.

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344. *Id.*

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