TO DISCLOSE OR NOT TO DISCLOSE? THAT IS THE QUESTION FOR THE CORPORATE FIDUCIARY WHO IS ALSO A PENSION PLAN FIDUCIARY UNDER ERISA: RESOLVING THE CONFLICT OF DUTY

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I. INTRODUCTION

The fall of the Enron Corporation in 2001 was a collapse of breathtaking proportions. A giant among the nation’s business enterprises was reduced to shambles. In addition to the company, there were many individual losers, including most prominently, the employee shareholders, whose pension plans consisted largely of Enron stock. Why did the employees follow such a foolish course by investing so heavily in Enron stock? Was it because the company required or at least encouraged it, even on the eve of its collapse?

It appears that Enron had entered into several clear conflict-of-interest transactions with a corporate officer, which were hopelessly losing propositions for the company, yet beneficial for the officer. When the deals were finally brought to light, it was revealed that the company had failed to report an additional $25 billion in these “off balance sheet”

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2. At the end of 2001, $1.3 billion of the pension plan’s $2.1 billion assets was invested in Enron stock. Id. at 92.

3. Charles M. Elson & Christopher J. Gyves, The Enron Failure and Corporate Governance Reform, 38 WAKE FOREST L. REV. 855, 861-62 (2003). These transactions were not disclosed on the company’s regular books. Id; see also Charles J. Tabb, The Enron Bankruptcy, in ENRON: CORPORATE FIASCOS AND THEIR IMPLICATIONS 303, 304 (Nancy B. Rapoport & Bala G. Dharan eds., 2004). There were several other mischievous transactions occurring at the company that were contrived to present a false image of the company’s financial state. See Reece, supra note 1, at 142-48 (outlining the events that occurred prior to Enron’s collapse).
The public reaction to disclosure of these transactions was a massive sell off of Enron stock, causing a plunge in the stock price in a matter of months from a high of $90.00 to a low of $1.00, eventually sending the company into bankruptcy. But alas, Enron does not stand alone in the annals of fallen corporate giants on account of financial wrongdoing, as many other companies would follow in its wake. In virtually all of these cases, non-employee shareholders filed suit, seeking to hold corporations and their directors liable under the securities laws for accounting misdeeds.

In the aftermath of the scandals, Congress passed the Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act of 2002, which imposes rigorous accounting review and reporting procedures on corporations and public accounting firms. First, the Act established “the Public Company Accounting Oversight Board ("PCAOB") to oversee the audit of public companies". The PCAOB was charged with, among other things, the registration of public accounting firms, adoption of rules on auditing, ethics, investigating improper conduct, disciplining companies, and enforcement of professional standards. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 101, 116 Stat. 745, 775-76 (2002) (codified in scattered sections of 15 U.S.C.). The Act prohibits accounting firms from also providing a variety of non-audit advisory services, including “bookkeeping,” “financial information systems design and implementation,” “appraisal or valuation services, fairness opinions, or contribution-in-kind reports;” Id. at § 201(g)(1)-(9). The Act further required public companies to set up audit committees composed of independent “member[s] of the board of directors”. Id. at § 301(3) (adding section 10A(m)(3)(A) to Securities Act of 1934). The audit committee is to have direct responsibility for the “oversight of the work” of the company’s accounting firm, id. at § 301 (adding section 10A(m)(2) to Securities Act of 1934), and must set up “procedures for the receipt . . . of complaints” and “anonymous submission by employees of the issuer of concerns regarding questionable accounting or auditing matters.” Id. at § 301 (adding section 10A(m)(4)(A),
corporate insiders who were pension plan fiduciaries to recover for losses to their pension plans. These employees alleged a breach of fiduciary duty by the plan trustees for continuing to fund the plan with the company’s stock and for not divesting the plan of the company’s stock despite being in possession of information that suggested continued investment was not wise. But, divesting a pension plan of the company’s stock based on inside information would mean trading it to a purchaser on the open market who did not possess the same information. The pension plan fiduciary is thus in a double bind: as a pension plan fiduciary, he has a duty under the Employee Retirement Income Security Act of 1974 ("ERISA"), to act to protect the assets of the plan, but as a corporate insider whose company’s shares are being traded, he has a duty under the Securities Exchange Act of 1934 not to trade or cause a trade on the basis of material non-public information.

The courts considering an apparently irreconcilable conflict of duty have taken conflicting views. The rulings on both sides of the issue are unsatisfying in that they offer no clear policy basis for one position over the other and provide the fiduciary and the corporate insider with little guidance on the proper course of action.

This Article examines this seeming irreconcilable conflict faced by the pension plan fiduciary, who is a corporate insider, to disclose or not to disclose material, inside information to plan participants, who would use the information to divest investments in company stock, without disclosing...
the same information to persons on the other side of these trades. The Article begins with a general discussion of the regulation of trade in securities and the history of the insider trading laws under the Securities Exchange Act of 1934. Part III discusses the soundness of the prohibition against insider trading. Part IV explains the duties imposed on pension plan fiduciaries and how they appear to conflict with the corporate fiduciary's duty not to trade based upon non-public, inside information. Part V discusses the varying positions taken by the courts that have considered the issue. Finally, Part VI explains ways of reconciling the two duties.

II. THE REGULATION OF TRADE IN SECURITIES: FORMAL AND TRUTHFUL DISCLOSURE

The object of the regulation of securities is truthful and meaningful disclosure. The two main laws that require formal disclosure about the facts of a company issuing securities are the Securities Act of 1933\textsuperscript{12} and the Securities Exchange Act of 1934.\textsuperscript{13} The basic strategy of the 1933 Act is to specify mandatory disclosure documents, the prospectus and registration statement,\textsuperscript{14} and to prohibit the sale or offer for sale of any security that has not been registered with the SEC\textsuperscript{15} or accompanied by a prospectus.\textsuperscript{16} Registration is intended to provide such disclosure of material facts concerning the company and the securities it proposes to sell, to enable investors to make a realistic appraisal of the merits of the securities and then exercise informed judgment in determining whether to purchase them.\textsuperscript{17} Registration requires, but does not guarantee, the accuracy of facts represented in the registration. While the Act prohibits

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\textsuperscript{16} 15 U.S.C. § 77b(a)(10) (2000). If written materials that do not comply with SEC rules are used prior to the effective date of the registration statement, or if any oral selling of the securities occurs by the corporation or its agents, the investor is entitled to rescind or recover recissory damages, irrespective of whether full disclosure had been made. 15 U.S.C. § 77l(a)(1) (2004).
\textsuperscript{17} U.S. Securities and Exchange Commission, supra note 14. Registration requires “a description of the company’s properties and business; a description of the security to be offered for sale [and its relationship to the company’s other capital securities]; information about the management of the company; and financial statements certified by independent accountants.” Id.
false and misleading statements under penalty of fine or imprisonment,\textsuperscript{18} it
does not preclude the sale of stocks in risky or poorly managed or
unprofitable companies or even harebrained schemes. It only requires
enough information so that the investor could see, were he astute, that it is
so.\textsuperscript{19}

The other formal disclosure law, the Securities Exchange Act of 1934,
requires periodic and continuous disclosure by certain companies.\textsuperscript{20}
However, unlike the prospectus, these periodic reports\textsuperscript{21} are not required to
be distributed to investors or shareholders, but are only filed with the SEC.
In large measure, these reports are not written to be comprehended by the
average lay investor, because of their factual density and quantitative
nature. However, as part of a company's annual report, the SEC requires
that companies prepare a "basic information package",\textsuperscript{22} which should
contain in a narrative, manageable form, a discussion by management of
the general conditions and operations of the company, discussing both
adverse and favorable trends and uncertainties.\textsuperscript{23}

A. Ad Hoc Disclosure Required Where Corporation has Chosen to Speak

Apart from the specific formal disclosure requirements of the
securities acts, it seems fairly well-settled that corporations and corporate
insiders have no general duty to disclose all non-public material

\textsuperscript{18} Id. Liability under the Act for material omissions or false statements is strict for the
issuer and based on negligence for secondary participants (including members of the board,
derunderwriters, accountants) who have to prove they exercised "due diligence" under the

\textsuperscript{19} Indeed, it is unlawful to represent that the Commission approves or disapproves of

\textsuperscript{20} The companies are those that have both a class of equity securities having more
than five hundred shareholders of record and more than $10 million in total assets. 15
U.S.C. § 12(g); 17 C.F.R. § 240.12g-1 (2006).

\textsuperscript{21} Companies must file a number of reports periodically, including an annual report
10-K (17 C.F.R. § 249.310), containing audited financial statements and information on the
issuer and its operations, a quarterly report 10-Q (17 C.F.R. § 249.308a), containing
unaudited financial statements, and a report 8-K, disclosing certain material changes in the
company's condition or operations within a specified period of time after they arise. (17
C.F.R. § 249.308). See generally U.S. Securities and Exchange Commission, Securities and
Exchange Commission Form List, www.sec.gov/about/forms/secforms.htm (last visited July
17, 2007) (listing forms for SEC filings and their descriptions).

\textsuperscript{22} Amendments to Annual Report Form, Related Forms, Rules, Regulations, and
Guides; Integration of Securities Acts Disclosure Systems, SEC Release No. 33-6321, 45

\textsuperscript{23} Management's Discussion and Analysis of Financial Condition and Results of
Operations, Item 303, Regulation S-K, 17 C.F.R. § 229.303 (2006); Management
Discussion and Analysis of Financial Condition, Sec. Act Rel. No. 33-6835 (May 18, 1989);
Interpretation, Commission Guidance Regarding Management's Discussion and Analysis of
information that it has about the corporation to shareholders. However, when a corporation makes a disclosure voluntarily or involuntarily, "there is a duty to make it complete and accurate." As it stands, in order to encourage and shore up investments, corporations often make "forward-looking statements", which purport to reflect predictions about earnings, revenue and future economic performance. So long as these statements contain sufficient cautionary language and are not knowingly misleading, corporations are not liable if the predictions do not come true.

B. Anti-fraud Provisions Under Section 10(b) and Rule 10b-5

The dilemma of the pension plan fiduciary and corporate insider being explored here would be covered by § 10(b) of the 1934 Act, which provides that it is unlawful:

To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . .

Pursuant to § 10(b), the Commission has adopted Rule 10b-5 which makes unlawful:

(a) To employ any device, scheme or artifice to defraud,
(b) To make any untrue statement of a material fact or omit to

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24. Grossman v. Novell, Inc., 120 F.3d 1112, 1125 (10th Cir. 1997); Reiss v. Pan American World Airways, Inc., 711 F.2d 11, 14 (2d Cir. 1983); see also Basic Inc. v. Levinson, 485 U.S. 224, 229 (1988) (implicitly finding that there was no general duty to disclose merger talks, but concluding that liability existed where a corporation chose to speak untruthfully). A corporation, though not under an original duty to disclose or speak publicly, after having done so, may be under a duty to update an earlier statement, such as where material changes have occurred. See Weiner v. Quaker Oats Co., 129 F.3d 310 (3d Cir. 1997); Backman v. Polaroid Corp., 910 F.2d 10, 16-17 (1st Cir. 1990). The stock exchanges require listed companies to promptly disclose to the affected securities markets material nonpublic information. See New York Stock Exchange Listed Company Manual §§ 202.03-202.06.


27. 15 U.S.C.A. § 77z-2; 17 C.F.R. § 230.175 (containing requirements for soft information that issuer must satisfy for protection under safe harbor).


state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or
(c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security.30

The statute and regulation are interpreted to make “insider trading” fraudulent. Two theories of “insider trading” under these laws have emerged from the courts and the SEC. Under the “traditional” or “classical theory,” § 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material, non-public information, without disclosing that information to the party on the other side of the transaction. Such trading is deceptive . . . because a relationship of trust and confidence [exists] between shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.31 [That relationship] gives rise to a duty to disclose [or to abstain from trading] because of the necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders.32

At common law, trading on inside information over the stock exchange was not regarded as unlawful or a breach of fiduciary duty by a director to a shareholder because directors were deemed to owe fiduciary duties to their corporations, not to individual shareholders.33 However, as an exception, the “special facts” doctrine worked to impose liability for non-disclosure of material facts in face-to-face securities transactions.34 The interpretation of Section 10(b) and Rule 10b-5 departed from the common law rule and imposed liability upon an insider for trading on the open market. In the first significant SEC enforcement action under § 10(b) and Rule 10b-5, In re Cady, Roberts & Co.,35 the SEC held an insider liable for trades in the open market based upon two rationales: “the existence of a

32. Id. at 652 (citing Chiarella v. United States, 445 U.S. 222, 228-29 (1980)) (alteration in original).
34. In Strong v. Repide, 213 U.S. 419, 431 (1909) the Court ruled that even if a director has no general duty to disclose facts known to him before he purchases shares, there are cases where “by reason of special facts, such a duty exists.” There, defendant, a director of the corporation and large stockholder, in charge of negotiations for the sale of certain lands by the corporation to the United States government, which sale would result in increased value to the corporation, failed to disclose these facts, particularly his control over the negotiations, to the seller of shares. Id. at 433.
relationship giving access... to information intended to be available only for a corporate purpose...” and the “inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.”

The Second Circuit, in SEC v. Texas Gulf Sulphur,37 affirmed the rule that prohibited such trading by insiders and developed a further justification for it. Under the “equal access to information theory,” the securities disclosure rules should be construed to promote the “justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.”38 This meant that there should be parity of information among market participants and “anyone in possession of material, inside non-public information” was required to “either disclose it to the investing public” or “abstain from trading in or recommending the securities concerned while such information remained undisclosed.”39

However, these theories were later rejected by the Supreme Court in Chiarella v. United States,40 where the Court held that not all instances of unfairness amount to fraud. In the case of nondisclosure, fraud occurs only if there is nondisclosure when there is a duty to speak.41 A duty to speak arises in the case of a fiduciary relationship or similar relationship of trust and confidence between the parties.42 In Chiarella, a printer whose company printed documents used in impending tender offers, and who bought shares based upon the information deciphered from these documents, did not engage in fraudulent conduct toward the sellers of those shares by his silence in the absence of any fiduciary relationship or relationship of trust and confidence with the company whose shares were traded or with the shareholders.43

1. Outsider Trading by Tippees

After Chiarella, the SEC sought to hold certain outsiders, those persons who acquired material non-public information from corporate insiders liable for insider trading; that they acquired the fiduciary duties of their inside sources merely by receiving inside information from them. But this argument too was rejected by the Supreme Court in Dirks v. SEC.44

36. Id. at 912.
37. 401 F.2d 833 (2d Cir. 1968) (en banc), cert. denied, 404 U.S. 1005 (1971).
38. Id. at 848.
39. Id.
41. Id. at 230.
42. Id.
43. Id. at 233.
44. 463 U.S. 646 (1983). In Dirks, an insider, Secrist, disclosed to Dirks, a stock
The Court affirmed its ruling in *Chiarella* that "[a duty to disclose] arises from the relationship between the parties . . . and not merely from one’s ability to acquire information because of his position in the market." As such, a tippee can be liable for trading on the basis of material non-public information only when the tippee knows or should have known that the disclosure of the information by the insider was improper and the tipper received some personal benefit from the disclosure.

2. Rule 14e-3

The SEC responded to the potential loopholes and limitations left after *Chiarella* and *Dirks* by adopting Rule 14e-3. The rule makes it unlawful to trade in shares the subject of a tender offer based on information obtained directly or indirectly from the tender offeror, the target company or insider of either of these persons, unless that information is public. This prohibition applies without regard to the existence of any common law fiduciary relationship between the trader and the corporation whose shares are traded or the shareholders, as required under Rule 10b-5. The Supreme Court upheld the power of the SEC to adopt such a rule despite this omission on the theory that the SEC’s prophylactic rulemaking power under § 14(e) was much broader than that under § 10(b); that the SEC could adopt measures "to prohibit acts not themselves fraudulent under common law or § 10(b), if the prohibition [was] ‘reasonably designed to prevent . . . acts and practices that [were] fraudulent . . . ’." If Rule 14e-3 seemed to plug a loophole in the theory of insider trading, it also resulted in the anomalous treatment of tender offers in comparison to the treatment of other securities transactions.

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45. Id. at 657-58 (quoting *Chiarella*, 445 U.S. at 232-33, n.14). The Court stated “[a]s market values fluctuate and investors act on inevitably incomplete and incorrect information, there always are winners and losers, but those who have ‘lost’ have not necessarily been defrauded. On the other hand, inside trading for personal gain is fraudulent, and in violation of the federal securities laws.” *Id.* at 667.

46. *Dirks*, 463 U.S. at 660-61, 662. That benefit could be direct as cash or indirect as a reputational advantage which could translate into a personal gain in the future, or it could be evidence of a “relationship between the insider and the recipient that suggests a quid pro quo.” *Id.* at 664. Even an attempt to make a gift of confidential information to a trading relative or friend can suffice, that being the same as the insider trading and giving the proceeds to the relative or friend. *Id.* at 664.


49. For example, in *SEC v. Switzer*, 590 F. Supp. 756, 758 (W.D. Okla. 1984), a famous football coach overheard a discussion by a corporate insider about an impending merger, bought shares based on this information then sold them in response to the announcement of
C. Fraud on the Source of the Information

The other theory of insider trading is the misappropriation theory, under which one can be liable for trading on information in breach of a duty owed to the source of the information.50

"[This theory] premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information."51 The anomaly here is that one avoids liability under the misappropriation theory by disclosing an intent to trade to the source of the information before trading, since this disclosure avoids the deception.52 But, this still leaves the party on the other side of the transaction exposed and subject to injury if disclosure is also not made to her.53

the merger, at a profit. He was convicted under insider trading laws, but his conviction was overturned as the trading took place before the adoption of Rule 14e-3 and was thus governed by Chiarella. Since he had no duty to the corporation or the shareholders from whom he purchased his stock, he was not liable under Rule 10b-5. However, if the transaction had been structured as a tender offer and Rule 14e-3 applied, his conviction would have stood.

50. O'Hagan, 521 U.S. at 652 (internal citation omitted).
51. Id.
52. Id. at 655.
53. Until recently, selective disclosure of material nonpublic information by corporate insiders to institutional investors, analysts and other market insiders was not proscribed by statute or regulation, absent a showing that the selective disclosure was made for the purpose of a personal benefit to the insider doing the disclosing. In August 2000, the SEC enacted Regulation FD. Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154 [2000 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶86,319, and 83,676 (Aug. 15, 2000), 17 C.F.R. § 243.100(a). The SEC was concerned with the apparent unfairness of the selective disclosures, including that issuers often disclosed important nonpublic information, such as advance warnings of earnings results, to securities analysts and institutional investors before making the information public, with the result that the investing public was not on an equal footing with market insiders and would therefore lose confidence in the integrity of the marketplace. Further, selective disclosure looked very much like tipping inside information. Also, the SEC saw a threat to the integrity of the markets by insiders selectively disclosing information in hopes of favorable reviews by analysts. Id. at 83,677-78. The rule requires that if an issuer makes disclosure of material information (including about "earnings", "mergers", "changes in assets", "new products") to selected persons, it must also make a public disclosure of the same information, simultaneously if the disclosure was intentional, 17 C.F.R. §243.100(a), 243.101(c) or within 24 hours or by the opening of the stock exchange the next day, if unintentional. 17 C.F.R. § 243.101(d). The regulation expressly excludes a "person who owes a duty of trust or confidence to the issuer," such as a temporary insider; and a "person who expressly agrees to maintain the disclosed information in confidence" 17 C.F.R.§ 243.100(b)(2). See generally Securities Exchange Release No. 43,154.
III. THE SOUNDNESS OF THE POLICY BEHIND THE PROHIBITION AGAINST INSIDER TRADING

There are at least three commonly offered justifications for the prohibition of insider trading:

1. to ensure fairness and equity--based on the "inherent unfairness involved where a party takes advantage of [inside] information, knowing it is unavailable to those with whom he is dealing;"\(^{54}\)
2. to promote the flow of information to the market, allowing it to better perform its function of evaluating securities and allocating capital--the "integrity of the market" theory; and
3. to protect the property rights of the corporation whose information is the basis for insider trading--"information intended to be available only for a corporate purpose and not for the personal benefit of anyone."\(^{55}\)

All three justifications, though, have been intensely debated. The unfairness is questioned on the assertion that insider trading does not cause trading by persons on the other side of the transaction because they would have been in the market anyway,\(^{36}\) and that it is a victimless offense.\(^{57}\)


\(^{55}\) Id.; see generally Kenneth Scott, Insider Trading, Rule 10b-5, Disclosure and Corporate Privacy, 9 J. LEGAL STUD. 801 (1980) (examining the rationales behind insider trading prohibitions).

\(^{56}\) See Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, 11 Sup. CT. Rev. 309 (1981). Easterbrook argues that even if trading by insiders cause other traders to sell before the rise in stock price after disclosure of material information, and "insider trading . . . reduces the likelihood that an active trader will obtain the highest possible price, investors might still not be harmed." Id. at 325. "If there is a chance that they will be short-changed as a result of insiders’ purchases, shareholders will respond by bidding less for the stock in the first place. The lower price compensates for the ex ante risk.” Id. Easterbrook explains: “If the discount accurately reflects the odds, then it is hard to see any unfairness in the process.” Id. And, “because all traders, at any given time, deal at the same price, the self-protective moves of sophisticated traders protect the unsophisticated as well.” Id. “The stockholders who lose out in one round of insider trading are compensated by the increased gains they obtain if their shares (purchased at a small discount) are not scooped up by insiders and thus appreciate more in other cases.” Id. However, the fallacy in this argument is in the “ifs” and the assumption that purchasers are knowledgeable about the frequency of insider trading; are sufficiently astute to discount the value of the shares; and that shareholders know the odds.

\(^{57}\) Manne argued that insider trading is a victimless crime, because the insider's trades did not prompt the investors' trade; they would have been in the market anyway, trading for their own reasons, and would perhaps have traded at less favorable prices if the insiders had not also been in the market. HENRY MANNE, INSIDER TRADING AND THE STOCK MARKETS 99-103 (1966). The theory being that the insiders' trades forced the stock price downward, resulting in a lowered purchase price to the outside trader and consequently a smaller loss after announcement of material adverse information causing a decline in the stock price. Id.
Some have criticized Chiarella in recognizing that anonymous trading on an impersonal exchange, which contains no "communicative content" could be said to be fraudulent as to persons who are trading contemporaneously, raising the question as to how insider trading can mislead and thus how a prohibition serves to avert deception. In response, one could say that purchasers of shares on an anonymous market are relying on a representation by the seller through his failure to disclose, that the market price reflects all available information necessary to setting a price, when in fact the insider/trader knows otherwise. Therein lies the deception. It seems that a more coherent basis for the prohibition concerns notions of fairness—that insiders should not profit from information obtained from their positions while the other beneficial owners of the corporation are disadvantaged.

Second, under the integrity of the market theory, the goal is to ensure that traders make deals based upon the same available information. Full information will reduce market volatility and investors will be inclined to enter the market without fear of acting in ignorance of material information. These effects will in turn produce greater allocative efficiency of the market.

Ian Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119, attempts to refute Manne’s argument that outside investors are not harmed: that any investor whose decision to enter the market, is in any way sensitive to price, is injured because such trader may find a “match in the market only because of the presence of insiders generating additional supply or demand on the other side.” Id. at 164.


59. Id. at 402-03.

60. Id.

61. Joel Seligman, *The Reformation of Federal Securities Law Concerning Non public Information*, 73 GEO. L.J. 1083, 1118 (1985). Seligman argues that the basis of the integrity of the market policy is both historical and theoretical, citing to President Roosevelt’s statement at the time of passage of the 1933 securities bill, that by “putting the burden of telling the whole truth on the seller,” the proposed act “should give impetus to honest dealing in securities and thereby bring back public confidence.” “The assumption [was] that investors [would] be more willing to purchase securities when compulsory disclosure of material information reduce[ed] the incidence of fraud, increase[ed] the reliability of estimates of firm value, and reduce[ed] the volatility of securities price swings. . . .” Id. at 1115.

62. Id. at 1118. Seligman suggests that mandatory disclosure will mean more rapid dissemination of material information which will improve “allocative efficiency,” in that “[i]nformation on firms with promising probable future earnings will cause the prices of these securities to rise; the market price for securities of firms whose earnings prospects are less promising will decline.” Id. at 1119. Thus, the market allocates its resources towards investments with the greatest prospects. Id. Easterbrook asserts that the market price of stock will not move unless other traders guess that insiders are trading based upon inside information. Easterbrook, *supra* note 56, at 336.
On the other hand, some argue that insider trading provides a corrective function to the market's pricing mechanism; the market reacting to trading, causing the price of shares gradually to reflect the information that was not public.\textsuperscript{63} The argument is that given that vast amounts of information are almost instantaneously registered, the markets themselves will provide an adequate price adjustment for any temporary informational asymmetries that benefit insiders.\textsuperscript{64} However, significant empirical evidence has shown that insider trading does not have a significant impact on market prices.\textsuperscript{65}

There is also the argument that if permitted to trade, insiders will have an incentive to delay disclosures so as to increase their opportunities to profit from the market's ignorance, thus harming outsiders who trade.\textsuperscript{66} As insiders will only trade stock when the market has either undervalued it (for a purchase) or overvalued it (for a sale),\textsuperscript{67} an innocent investor is denied the profits he or she otherwise would have realized or become poorer because she spends more than the stock is worth.\textsuperscript{68} Real concerns about stock manipulation exist also. Management might be motivated to make news about the company's stock through press releases and other communications to cause movement in the stock price, then sell or buy at a profit. Managers might also become more risk prone, knowing that inside information will enable them to escape from the market to avoid losses in

\textsuperscript{65} Seligman, \textit{supra} note 61, at 1096. \textit{See also} Lee, supra note 57, at 170 (discussing how although the market receives information constantly, market prices do not reflect "consensus" forecasts); Gilson & Kraakman, \textit{The Mechanisms of Market Efficiency}, 70 VA. L. REV. 549, 579 (1984).
\textsuperscript{66} Lee, \textit{supra} note 57, at 160.
\textsuperscript{67} Lee, \textit{supra} note 57.
\textsuperscript{68} Seligman, \textit{supra} note 61, at 1098. Seligman gives the example of an insider who knows that a mineral discovery will double the firm's stock price from $10.00 per share to $20 per share.

If the insider buys stock at $10 per share from existing stockholder A, the insider has not harmed A. Stockholder A was willing to sell at $10 per share in any event. But potential stockholder B, who would have bought stockholder A's shares at $10 per share, has been harmed . . . . At the least, potential stockholder B must pay a higher price for other shares than the shares otherwise would have commanded. At the most, potential stockholder B may find the new price too high and may not purchase at all, thereby losing the profit he or she otherwise would have enjoyed as the stock price rose from $10 to $20 per share.

\textit{Id.} at 1098. But Seligman's example is too narrow. Would shareholder A, even though inclined to sell, have sold to the insider at $10, if she had the same information as the insider? The rational seller would hold out for more.
time. This may very well describe the goings on in Enron during its final months when the board of directors deviated from its very strict ethics policy regarding self-dealing transactions by allowing an executive to deal with the company in off-book transactions that were a drain on company revenues. Ken Lay, the chief executive officer, kept urging public investment in the company's shares, all the while disposing of millions of shares in his own accounts, not disclosing what he knew about the underlying fraud and impending collapse.

The third rationale for the prohibition on insider trading, that is, to protect the information rights of the corporation, has been debated on the ground that state common law rules on theft and conversion are sufficient to address the corporate business property concern. Also, it is said that express provisions in employment and other written contracts could more efficiently limit the use of such information by insiders. Indeed, some have argued that insider trading should be allowed as a form of executive compensation which encourages valuable entrepreneurial initiative. However it is not likely the case that insider information is the result of entrepreneurial innovation as opposed to the fortuity of being an insider and privy to valuable information.

The debate over the merits of the prohibition of insider trading takes on a wholly different dimension when it is asserted by employee-shareholders that not all trading on the basis of material non-public information should be prohibited, that is, they should be permitted to dispose of company stock on this basis when necessary to safeguard their pension plans funded primarily by company stock. They would extend the rationale for not prohibiting trading in the absence of a duty, to not prohibiting trading where there is a dual duty, such as that owed by a plan fiduciary who is also a corporate insider privy to material non-public information.

IV. ERISA AND FIDUCIARY DUTY TO PLAN PARTICIPANTS

In 1974, Congress adopted the Employee Retirement Income Security

69. Id. at 1095.
71. See Elson & Gyves, supra note 3.
72. MANNE, STOCK MARKETS, supra note 57, at 132-41; Carlton & Fishchel, supra note 63, at 870.
73. Scott, supra note 55, at 808.
Act, designed to regulate "employee investment, pension, and health benefit plans by setting certain minimum standards for participation, vesting, and funding, and imposing various fiduciary duties on those who manage such plans." Congress aimed to "protect and strengthen the rights of employees, enforce uniform fiduciary standards, and encourage employers to create and maintain benefit plans for employees."

A. Defined Contribution Plans and Defined Benefit Plans

There are two basic types of pension plans contemplated by ERISA: defined-benefit and defined-contribution plans. Defined-benefit plans "pay fixed or determinable benefits . . . to participants who retire at a certain age." The employer determines the amount of these benefits and sets aside the necessary funds. Under defined-contribution plans, on the other hand, benefits depend on the contributions made by the employees, earnings and matching contributions made by the employer.

The trend in recent years had been for employers to offer defined contribution plans and not defined-benefit plans. More than eighty percent of all pension plans are defined contribution plans and they cover more than sixty percent of all plan participants. This trend is remarkable in that the two types of plans differ dramatically in their allocation of investment risk between employee and employer. Under the defined-benefit plan, the employer bears the risk that it will not have allocated sufficient funds to make the promised payments or if those funds allocated are invested in securities that lose value. In contrast, under a defined-

76. Levy, 287 F. Supp. 2d at 835.
80. Id.; see Lorraine Schmall, Defined Contribution Plans After Enron, 41 Brandeis L.J. 891, 905-06 (arguing that defined contribution plans should not be considered pension plans because the real risks that investments will perform poorly negates a secure retirement). Defined Benefit plans, but not defined contribution plans, are also insured by the Pension Benefit Guaranty Corporation, a federal agency that steps in to pay a percentage of private benefits when the plans terminate the pension with insufficient assets. Pension Benefit Guarantee Corporation, http://www.pbgc.gov (last visited July 7, 2007).
81. Millon, supra note 78, at 838.
contribution plan, the employee who directs investments, will realize benefits based upon the value created by those investment choices.\textsuperscript{83}

Typically, under the defined contribution plan, the employees choose from among various mutual funds and other investment choices offered by the employer, which can include the employer’s own stock. The employer’s matching contribution can and is often in the form of company stock and under many such plans, this is the only option available.\textsuperscript{84} These plans typically preclude employees from selling company stock to reinvest the proceeds until she reaches a stated age, most commonly fifty, fifty-five, or sixty.\textsuperscript{85} In consequence, many defined contribution plans are heavily invested in company stock, nearly forty-two percent.\textsuperscript{86} At Enron, that percentage approached two-thirds.\textsuperscript{87} This is because diversification is not required under ERISA for defined-contribution plans, (although it is required for defined benefit plans where the investment portfolio may not hold more than ten percent of its value in company stock).\textsuperscript{88} Indeed, with Employee Stock Ownership Plans (“ESOPs”), which are funded solely by company stock, Congress sought to develop plans that would function as both an “employee retirement benefit plan and a technique of corporate finance” that would encourage employee ownership of a company.\textsuperscript{89}

While the employer’s stock represents a large percentage of the employee’s pension plan, the same investment represents only a small percentage of the company’s total outstanding shares—at Enron only two percent—meaning that employees have little or no power within the corporation by virtue of shareholder status.\textsuperscript{90}

B. Fiduciaries Under ERISA

ERISA imposes personal liability upon pension plan fiduciaries for

\begin{itemize}
  \item \textsuperscript{83} Millon, \textit{supra} note 78, at 838.
  \item \textsuperscript{84} \textit{Id.} at 839. At Enron, the defined contribution plans provided that the employer’s contribution “should be” or “at all times will be primarily in shares of” company stock. \textit{In re} Enron Corp. Sec., Deriv. \& “ERISA” Litig., 284 F. Supp. 2d 511, 549 (S.D. Tex. 2003). That stock could not be traded until the employee reached age 50. Millon, \textit{supra} note 78, at 839; Schmall, \textit{supra} note 80 at 894 n.10.
  \item \textsuperscript{85} Reece, \textit{supra} note 1, at 94.
  \item \textsuperscript{86} Millon, \textit{supra} note 78, at 839 (citing Shlomo Benartzi \& Richard H. Thaler, \textit{Naive Diversification Strategies in Defined Contribution Savings Plans}, 91 AM. ECON. REV. 79, 90 (2001)).
  \item \textsuperscript{87} \textit{Id.} at 839 (citing Patrick J. Purcell, \textit{The Enron Bankruptcy and Employer Stock in Retirement Plans}, at 3 (CRS Report for Congress) (Jan. 22, 2002), available at http://www.house.gov/boosman/issues/crsreponron.pdf); Reece, \textit{supra} note 1, at 92.
  \item \textsuperscript{88} 29 U.S.C. \& 1107(a)(2) (2006).
  \item \textsuperscript{89} Kuper v. lovenko, 66 F.3d 1447, 1457 (6th Cir. 1995).
  \item \textsuperscript{90} Millon, \textit{supra} note 78, at 842.
\end{itemize}
volutions of their duties to plan participants.\footnote{91} Determining who is a fiduciary is often not a simple matter of looking to a person’s title. It is generally held that an individual is not held liable as a fiduciary under ERISA merely because that individual is also director, officer, shareholder or manager of the corporate employer.\footnote{92} Rather, the “threshold question” is whether that person was acting as a fiduciary (that is, performing a fiduciary function) when taking the action subject to complaint.\footnote{93}

A fiduciary may be either a named fiduciary or a \textit{de facto} fiduciary. A named fiduciary is one “named in the plan instrument, or . . . is identified as a fiduciary by the employer or employee organization,” acting either separately or jointly.\footnote{94} Typically, the employer, its board of directors and chief executive officer will be named fiduciaries with power of management and investment over plan assets. As this language shows, under ERISA, a fiduciary need not be an independent party.\footnote{95}

\footnote{91} 29 U.S.C. § 1109 (2006) (stating that a fiduciary shall be personally liable to make good to such plan any losses to the plan resulting from each such breach); see also 29 U.S.C. § 1103(a); 1102(a)(1) (requiring pension funds to be held in trust).
\footnote{92} Sommers Drug Stores Co. Employee Profit Sharing Trust v. Corrigan Enterprises Inc., 793 F.2d 1460 (5th Cir. 1986); In re Dynergy, Inc. ERISA Litigation, 309 F. Supp. 2d 861, 899 (S.D. Tex. 2004); Hull v. Policy Management Systems Corporation, No. 3:00-778-17, 2001 U.S. Dist. LEXIS 22343, *17-18. (D.S.C. Feb. 9, 2001) (where authority to make investment decisions as to employer-matching contributions was vested in the plan committee, board defendants not liable for those decisions). A corporation and its board may wear “two hats”: that of employer and of ERISA fiduciary. “ERISA liability arises only from actions taken or duties breached in the performance of ERISA obligations.” In re Worldcom, Inc., 263 F. Supp. 2d 745, 760 (S.D.N.Y. 2003) (holding member of board of company, which was the plan administrator with the power to appoint individuals, including “any” Worldcom officer as fiduciary were not fiduciaries by virtue of their powers under state law to manage the corporation); Pegram v. Herdrich, 530 U.S. 211, 225-26 (2000) (administrator “is fiduciary only ‘to extent that he acts in such a capacity’”). This enables courts to avoid the conceptual difficulties in imposing personal liability in such instances where the corporation can only act through its officers; that they are not liable solely by virtue of holding office. In re Enron Corp. Sec., Deriv. & “ERISA” Litig., 284 F. Supp. 2d 511, 567 (S.D. Tex. 2003) (citing Confer v. Custom Engineering Co., 952 F.2d 34, 37 (3d Cir. 1991)) (“when an ERISA plan names a corporation as a fiduciary, the officers who exercise discretion on behalf of the corporation are not fiduciaries within the meaning of [ERISA] unless it can be shown that these officers have individual discretionary roles as to plan administration.”); see also 29 C.F.R. § 2509.75-8, at D-5 (1991)).
\footnote{94} 29 U.S.C. § 1102(a)(2).
\footnote{95} Employers typically name other persons or committees to see to the day to day activities of the administration of the plan, such as a plan administrator or administration committee (made up of members of the employer’s board of directors) and an investment committee (usually appointed by the employer). Usually, there is a plan Trustee with direct management, investment and disposition powers over the plan’s assets. The power to appoint, retain, or remove the trustee typically resides in the named fiduciary. ERISA provides a safe harbor from liability for a named fiduciary to the extent he has allocated or designated his fiduciary responsibilities to another. See 29 U.S.C. § 1105(c)(2). However,
A de facto fiduciary is one by virtue of her "functional authority and control relative to the plan," i.e., she "exercises any discretionary authority or discretionary control respecting management of such plan . . . [over the] disposition of its assets," "renders investment advice for a fee or other compensation" or "has any discretionary authority or discretionary responsibility in the administration of such plan." Under this broad definition, "a person is a fiduciary only with respect to those aspects of the plan over which he exercises authority or control." However, where a person actually exercises any authority or control over the management or disposition of the assets of the plan, formal or delegated discretion to do so is not required for a finding that that person is a fiduciary.

this appointment power carries a duty to monitor to "ensure that the [ ] [appointees'] performance has been in compliance with . . . the statutory standards, and satisfies the needs of the plan." In re Enron, 284 F. Supp. 2d at 553, n.59 (quoting 29 C.F.R. § 2509.75-78, at FR-17); Electronic Data Systems Corp. "ERISA" Litigation, 305 F. Supp. 2d 658, 670 (E.D. Tex. 2004) (finding that a duty to monitor appointees by fiduciaries with appointment power is imposed by ERISA); Leigh v. Engle, 727 F.2d 113, 135 (7th Cir. 1984) (those fiduciaries responsible for selecting and retaining the plan administrators "had a duty to monitor appropriately the administrators' actions"); In re Westar Energy, Inc. ERISA Litig., 2005 U.S. LEXIS 28585, *25, 30-31 (D. Kan. September 29, 2005) (liability for continuing allocation to persons that named fiduciary knew or should have known were not qualified to "loyally and prudently manage the plan's assets" who engaged in risky activities).

A directed trustee is one who is required to invest funds and follow in every material respect directions given to him by the plan administrator. 29 U.S.C. §1103(a)(1). However, information known or should have been known to the directed trustee should prompt him to reject those directions. Worldcom, 263 F. Supp.2d at 755-56, 758, 765.


98. Electronic Data Systems ERISA Litigation, 305 F. Supp. 2d at 666-67, 668 (persons having ultimate decision-making authority as to all fiduciary functions; those with authority to appoint with final review over actions taken, and those with authority over day to day administration, could be functional fiduciaries); In re Enron, 284 F. Supp. 2d at 544; see also FirsTier Bank, N.A. v. Zeller, 16 F.3d 907, 911 (8th Cir. 1994) (fiduciary duty arises where from exercise of discretionary authority or control over plan management, and also when dealing with plan assets), cert. denied sub nom. Vercoe v. FirsTier Bank, N.A., 513 U.S. 871 (1994).

99. Electronic Data Systems, ERISA Litigation, 305 F. Supp. 2d at 671; Martin v. Feilen, 965 F.2d 660, 669-70 (8th Cir. 1992); In re Enron, 284 F. Supp. 2d at 553, 661.
C. The Fiduciary Duties Under ERISA

Under Section 1104(a)(1) of ERISA, a pension plan fiduciary must: "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries" for the purpose of providing benefits to the beneficiaries. These duties include the duty to act prudently, to follow directives, to monitor, to diversify, to act with loyalty and to disclose. This list does not purport to be an exhaustive one. Instead, Congress expected the courts to engraft the common law of trusts upon ERISA to define the general scope of fiduciary authority and responsibility. In determining the relevant scope of the fiduciary duty, courts endeavor to balance the competing congressional purposes: on the one hand, Congress desired to "offer employees enhanced protection for their benefits, and on the other," Congress desired "not to create a system that is so complex that administrative costs and litigation expenses unduly discourage employers" from creating pension plans. Yet, courts have held that plan trustees have fiduciary duties that are the "highest known in the law." 103

1. The Duty to Act Prudently

Fiduciaries must act "for the exclusive purpose of providing benefits to participants" and "with the care, skill, prudence, and diligence under the circumstances then prevailing" that a prudent man would exercise under like circumstances and "in accordance with . . . the plan." 104 Whether a fiduciary meets this standard is an objective test, with consideration given to whether the fiduciary "utilized proper methods to investigate, evaluate and structure the investment" and "exercised independent judgment." 105


102. Varity Corp., 516 U.S. at 496.


104. 29 U.S.C.A. § 1104(a)(1)(A), (B), (C).

105. In re Enron, 284 F. Supp. 2d at 548 (quoting Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc., 173 F.3d 313, 317 (5th Cir. 1999), cert. denied 528 U.S. 967 (1999)). Department of Labor Regulations at 29 C.F.R. § 2550.404a-1(b), offers guidelines as to when requirements are satisfied, including having

"appropriate consideration to those facts and circumstances that, . . . are relevant to the particular investment or investment course of action, including the role [it] plays in that portion of the plan's investment portfolio . . . ." Whether "the particular investment or investment course of action is reasonably designed . . . ."
The test is one of conduct, not an assessment of performance of the investments.\textsuperscript{106} To hold a fiduciary liable, it must be shown that had an investigation been conducted, the improvidence of the investment would have been made known.\textsuperscript{107}

2. The Duty to Diversify

ERISA specifies that plan investments must be diversified unless it is clearly prudent not to diversify.\textsuperscript{108} However, as stated earlier, there is an exception for ESOPs, where ownership of company stock is a principal purpose of the plan. In such cases, fiduciaries are generally not obligated to diversify unless the failure to diversify would not be in the interests of the plan participants.\textsuperscript{109} Thus, there is a presumption that continued investment in the company’s stock is proper. To rebut the presumption, a plan participant must show that the fiduciary “could not reasonably believe that the plan’s drafters would have intended under the circumstances that he continue to comply with the ESOP’s direction that he invest exclusively in employer securities.”\textsuperscript{110} This requires a showing of more than a mere

\begin{quote}
“to further the purposes of the plan, . . . consider[ing] the risk of loss and the opportunity for gain (or other return) . . . .”

Consideration of the extent to which the “portfolio” is diversif[ied] . . . ”

“[t]he [l]iquidity and current return of the portfolio[,] . . . the projected return of the portfolio . . . .”
\end{quote}

Hence, “because opportunities [are necessarily foregone], an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investment with commensurate rates of return.” Interpretive Bulletin, Dep’t of Labor, 29 C.F.R. § 2509.94-1.

\textsuperscript{106} In Re Enron, 284 F. Supp. 2d at 548; Laborers Nat’l Pension Fund v. Northern Trust Quantitative Advisors, Inc., 173 F.3d at 317.

\textsuperscript{107} Kuper v. Iovenko, 66 F.3d 1447, 1460 (6th Cir. 1995); see also Barker v. Am. Mobil Power Corp., 64 F.3d 1397, 1403 (9th Cir. 1995) (ERISA fiduciary has duty to investigate suspicion he has with respect to plan funding and maintenance); In re Dynegy, Inc. ERISA Litigation, 309 F. Supp. 2d 861, 889 (S.D. Tex. 2004) (complaint failed to allege sufficient facts to show investigation would have revealed company’s financial improprieties).

\textsuperscript{108} 29 U.S.C. § 1104(a)(1)(C). ERISA’s duty to diversify, however, is not measured by hard and fast rules or formulas. Instead, Congress recognized that the degree of investment concentration will depend upon the facts and circumstances of each case. Among the considerations are: “the purposes of the plan”; “the amount of the plan assets”; “financial and industrial conditions”; “the type of investment”, e.g., “mortgages, bonds or shares of stock . . . .”; “distribution as to industries”; “the dates of maturity.” H.R. Conf. Rep. Rep. No. 1280, 93d Cong., 2d Sess. (1974), reprinted in 1974 U.S. Code Cong. & Admin. News 5038, 5085.

\textsuperscript{109} 29 U.S.C. § 1104(a)(2).

\textsuperscript{110} Moench v. Robertson, 62 F.3d at 553, 570, 571-72 (3d Cir. 1995); Kuper, 66 F.3d at 1459 (6th Cir. 1995); In Re Enron, 284 F. Supp. 2d at 534; Hill v. BellSouth, 313 F. Supp.
To DISCLOSE OR NOT TO DISCLOSE?

To disclose or not to disclose? That is the question. Some courts hold that where a plan's documents require the employer match to be made in company stock, a fiduciary cannot be liable for not diversifying investments. However, other courts hold the contrary, that a plan cannot include a per se prohibition against diversification, for that would cause the fiduciary to violate the main command of ERISA, that fiduciaries act solely in the best interest of beneficiaries.

A fiduciary may be absolved of liability if the assets are not diversified where a plan participant's exercise of individual control over the assets of an individual account resulted in a loss.

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111. Lalonde v. Textron, 369 F.3d 1, 4 (1st Cir. 2004); Moench, 62 F.3d at 572; Kuper, 66 F.3d at 1460; Wright v. Oregon Metallurgical Corporation, 360 F.3d 1090, 1097-98 (9th Cir. 2004) (declining to adopt expressly the Moench and Kuper standards, but finding on facts, that plaintiff's complaint failed to show company's financial condition was seriously deteriorating to rebut the presumption; also noting "genuine risk of insider self-dealing" if information was disclosed).

112. See, e.g., In re Dynegy, Inc. ERISA Litigation, 309 F. Supp. 2d at 896 (fiduciary not liable for "failing to comply with plan by refusing to direct the diversification of employer matching grants out of employer stock or into diversified investments"); In re McKesson HBOC, Inc. ERISA Lit., No. C00-20030RMW, 2002 U.S. Dist. LEXIS 19473, at *13-14, *17 (N.C. Cal. Sept. 30, 2002) (plan required all matching contributions to be in company stock and defendant fiduciary had no discretion as to form of employer contribution, particularly where plaintiffs failed to show a causal link, i.e., "that an adequate investigation would have revealed to a reasonable fiduciary that the investment at issue was improvident.")

113. See, e.g., Kuper, 66 F.3d at 1457; In re Enron Corp, 284 F. Supp. 2d at 534; Hill, 313 F. Supp. 2d at 1367, 1368.

114. 29 U.S.C. § 1104(c)(1)(B). However, Section 1104(c) does not provide an automatic exemption. The Department of Labor has promulgated regulations on this issue. The regulations require that to qualify, the plan must inform the participants that the plan is intended as a plan under Section 1104(c) of ERISA and that "fiduciaries . . . may be relieved of liability for any losses which are the direct and necessary result of investment instructions given by such participant or beneficiary." 29 C.F.R. § 2550.404c-1(b)(2)(i)(B)(1)(i). The plan must also allow participants the opportunity to "exercise control over assets" and to choose from a "broad range of investment alternatives," how assets are invested. Id. at §2550.404c-1(b)(2)(i)(B)(1)(i). In exercising control, the participant must be afforded an opportunity to give investment instruction with appropriate frequency and "obtain sufficient information to make informed investment decisions." Id. at § 2550.404c-1(b). See also In re Unisys Sav. Plan Litigation, 74 F.3d 420, 440, 447-48 (3d Cir. 1996) (evidence failed to show that the plan participants were given sufficient information to ascertain the breadth of actual plan investments or to assess all of the investment alternatives available and thus there were significant restrictions on the ability to make transfers); In re Enron, 284 F. Supp. 2d. at 577 (concealment of material non-public facts about the company's financial condition meant plan did not qualify as an 1104(c) plan).
3. Duty of Loyalty

Perhaps "'[t]he most fundamental duty of ERISA plan fiduciaries is a duty of complete loyalty'" requiring "'fiduciaries [to] discharge their duties 'solely in the interests of the participants and beneficiaries,' and to 'exclude all selfish interest and all consideration of the interests of third persons.'" This duty has its source in the common law of trusts.

The duty of loyalty is compromised, to an extent, by the "two hat" rule, under which an employer-fiduciary may act as both a fiduciary to an ERISA plan and as an employer or other officer with an obligation to the company. In these dual roles, employers are permitted to act in accordance with their interests as employers, even when adverse to the interests of the beneficiaries, so long as they are not at the time acting as an ERISA fiduciary. Thus, pure business decisions (such as amending or terminating a plan) by an ERISA employer are not governed by a duty of prudence or a loyalty requirement.

Significantly, for our purposes here, the decision to provide a company stock fund as an investment option or to make contributions to employees' retirement funds with company stock are held to be decisions made in a fiduciary capacity, rather than business decisions.

118. Kuper, 66 F.3d at 1456; In re CMS Energy ERISA Litigation, 312 F. Supp. 2d 898, 911 (E.D. Mich. 2004). Similarly, decisions characterized as settlor functions as to the form or structure of the plan such as entitlement to, calculation and amounts of benefits; whether plan participants can direct the plan’s fiduciaries to purchase company stock; imposing age and other restrictions on the ability of the participants to direct the plan’s fiduciaries to transfer plan assets out of company stock, do not trigger fiduciary duties. Hughes Aircraft Co. v. Jacobson, 525 U.S. 442, 444-445 (1999); see also Pegram, 530 U.S. at 226 ("[S]pecific payout detail of the [ERISA] plan was, of course a feature that the employer as plan sponsor was free to adopt without breach of any fiduciary duty under ERISA, since an employer’s decisions about the content of a plan are not themselves fiduciary acts."); Lockheed Corp. v. Spink, 517 U.S. 882, 887 (1996) ("Nothing in ERISA requires employers to establish pension plans. Nor does ERISA mandate what kind of benefits employers must provide if they chose to have such a plan."); Smith v. Contini, 205 F.3d 597, 602 (3d Cir. 2000) ("We start our discussion of the issues by recognizing that ERISA neither mandates the creation of pension plans nor in general dictates the benefits to be afforded once a plan is created."). Thus, an employer-sponsor of a pension plan can fire an employee for reasons not related to the ERISA plan or can modify the terms of a plan to be less generous to the beneficiary.

119. In re CMS Energy, 312 F.Supp.2d at 911; see also In re Westar Energy, 2005 U.S. Dist. LEXIS 28585 at *65-66 (where defendants had discretionary authority to eliminate
a. The Duty to Disclose

The extent to which a plan administrator must make disclosure to plan participants apart from the formal disclosures expressly required by ERISA is an unsettled issue, but is generally viewed as being informed by the common law. Indeed, the duty to disclose under ERISA has been described as an “area of developing and controversial law.” The duty to disclose has also been stated as “a constant thread in the relationship between beneficiary and trustee; entail[ing] not only a negative duty not to misinform, but also an affirmative duty to inform when the trustee knows that silence might be harmful.”

This enlarged duty is based upon a recognition that the disparity of expertise and knowledge between the lay beneficiary and the trained fiduciary, requires reliance by the beneficiary on the fiduciary. Thus, a fiduciary has a duty to disclose when there are “material facts affecting the interest of the beneficiary which [the fiduciary] knows the beneficiary does

company stock as an investment option, decision not to, was not a business decision outside of ERISA fiduciary duties). But see Xcel Energy, Inc., Sec., Deriv. & “ERISA” Lit., 312 F. Supp. 2d 1165 (D. Minn. 2004) (holding that part of plan requiring employer matching contributions to be in company stock was a plan design decision).

120. ERISA expressly requires plan administrators to make certain information available to plan participants, including a summary plan description, certain annual and supplementary reports, and a statement of accrued benefits. 29 U.S.C. §§ 1021-1026 (2006).

121. See Bd. of Trs. of the CWA/ITU Negotiated Pension Plan v. Weinstein, 107 F.3d 139, 143-46 (2d Cir. 1997). Courts have relied on the legislative history that “the principles of fiduciary conduct are adopted from existing trust law, but with modifications appropriate for employee benefit plans.” H.R. REP. No. 93-533 at 12-13 (1973), reprinted in 1974 U.S.C.C.A.N. 4639, 4650-51.


124. In re Unisys, 74 F.3d at 441.
not know, but needs to know for his protection, even in the absence of a specific request for information, where the participant has "no reason to suspect that it should make inquiry into what may appear to be a routine matter." Some courts have limited the duty of affirmative disclosure to circumstances where the information would have an "extreme impact" on plan beneficiaries. It seems that most of the cases confronting the conflict of duty by the ERISA fiduciary/insider, have involved this kind of information, yet these cases conflict as to whether a duty of disclosure arises, regardless of what the plan participant is privileged to do with the information.

V. IRRECONCILABLE DECISIONS FROM THE COURTS ON AN IRRECONCILABLE CONFLICT

Where an ERISA fiduciary is privy to material non-public information about the company's health, do the general duties of prudence and loyalty require the fiduciary to advise plan participants about the wisdom of investing in company stock in light of this non-public information? As stated earlier, the decision whether to fund the matching contributions with company stock is not a business decision, but one requiring fiduciary concerns. Would such disclosure, if plan participants act to divest these holdings, amount to prohibited insider trading? Is the ERISA fiduciary an insider for purposes of the securities laws?

126. In re Enron Corp., 284 F. Supp. 2d at 556 (quoting Glaziers and Glassworkers Union Local No. 225 Annuity Fund v. Newbridge Securities, Inc., 93 F.3d 1171, 1181 (3d Cir.1996)); see also Griggs, 237 F.3d at 371; Bins v. Exxon Co. U.S.A., 189 F.3d 929, 939 (1999) (disclosure whether or not information is asked for); Anweiler v. Am.Elec. Power Svc. Corp., 3 F.3d 986, 991 (7th Cir. 1993); Schmidt v. Sheet Metal Workers' Nat. Pension Fund, 128 F.3d 541, 546-47 (7th Cir. 1997) (disclosures where silence could be misleading); Adams v. Freedom Forge Corp., 204 F.3d 475, 480, 492 (3d Cir. 2000); Eddy v. Colonial Life Ins. Co., 919 F.2d 747, 750 (D.C. Cir. 1990) (advice required on circumstances that threaten the beneficiary's interests). Some courts, however, refuse to read an additional disclosure obligation beyond those stated in ERISA into the fiduciary duty provisions because ERISA deliberately defined fiduciary and disclosure obligations in separate sections of the statute. See Bd. of Trs. of the CWA/ITU Negotiated Pension Plan v. Weinstein, 107 F.3d at 147 (Congress's deliberate structure of required disclosure limits kinds of documents to be disclosed); Faircloth v. Lundy Packing Co., 91 F.3d 648, 657 (4th Cir. 1996) (general disclosure duty not recognized); Porto v. Armco, Inc., 825 F.2d 1274, 1276 (8th Cir. 1987) ("[A]n administrator who complies with the statutory standard for disclosure cannot be said to have breached the fiduciary duty by not providing earlier disclosure"); Ehlmann v. Kaiser Found. Health Plan of Tex., 198 F.3d 552, 556 (5th Cir. 2002) (no general duty to disclose beyond specific disclosure provisions of ERISA).
In Dirks v. SEC, the Supreme Court explained that persons who are not traditional insiders of corporations, such as accountants, lawyers and advisers, who become privy to corporate information on a confidential basis, may be regarded as insiders for purposes of insider trading prohibitions. An ERISA fiduciary who is the chief executive officer, a member of the board of directors or other high officer, such as a director of benefits, would seem to fall within this meaning and therefore may be limited to making disclosures for legitimate corporate purposes only.

Would disclosure by this ERISA fiduciary of what a plan participant “needs to know for his protection” be a legitimate corporate purpose? It is arguably so, where the insider undertakes to act in a fiduciary capacity. If it is, then under Dirks, plan participants would not be liable as tippees for their divestment. If insiders, who are ERISA fiduciaries, may not legitimately make these discreet disclosures, then there would be prohibited insider trading.

While some courts have found no general duty to communicate what is clearly material information affecting the plan participants’ interests, finding such a duty constrained by the prohibitions on insider trading, other courts have found that there is a duty to disclose both to the plan participants and to the public if the disclosure to plan participants would result in divestment of company stock. The case law to date provides little guidance as to the rightful and least harmful course for the fiduciary to take.

A. No Breach of Duty to Act Prudently or to Disclose

In Hull v. Policy Management Systems Corporations, plaintiffs were participants in the company’s 401(k) retirement savings plan. They alleged a breach of fiduciary duty by the plan fiduciaries for misinforming them and failing to obtain and provide accurate information related to the corporation’s value. Specifically, plaintiffs alleged, the failure to give

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129. See Dirks, 463 U.S. at 655, n. 14.
130. See cases discussed, infra at text accompanying notes 132 to 153.
131. See cases discussed, infra at text accompanying notes 154 to 247.
133. Id. at *4-5. Employees contributed a percentage of their salary to their individual accounts and they decided how these funds would be invested. The employer matched some of the employee contributions in company stock; these matching funds did not, however, vest immediately and the employee lacked control over the funds until they did. Id. A committee of three individuals appointed by the board made the investment decisions as to the non-vested employer-matching funds. Id. at *5. The Plan empowered the Board of Directors to appoint and remove members of the committee, but provided that the “Board shall have no other responsibilities with respect to the plan.” Id. at *18.
134. Id. at *4-5.
accurate information caused the plan to continue to purchase and retain company stock as employer-matching contributions to the plan, at a time when the share price was overvalued.\textsuperscript{135} As the corporation continued to contribute company stock, the price dropped sharply after certain negative information was released to the general public.\textsuperscript{136}

The court refused to read into the language creating the board's authority over the plan, a requirement that the corporation keep the plan committee "informed of what [could] only be characterized as 'inside information' for use in the making of its investment decisions."\textsuperscript{137} The court found no general fiduciary duty to disclose owed by the employer to the plan and dismissed the claims accordingly.\textsuperscript{138}

In essence, the court found that plaintiff sought to hold the Plan Committee defendants liable under a standard which would put the Committee in the untenable position of choosing one of three unacceptable (and in some instances illegal) courses of action: (1) obtain "inside" information and then make stock purchase and retention decisions based on this "inside" information; (2) make the disclosures of "inside" information before acting on the discovered information, overstepping its role, and in any case, likely causing the stock price to drop; or (3) breach its fiduciary duty by not obtaining and acting on "inside" information.\textsuperscript{139}

The court did not decide whether plaintiff's assertion that at least the decision to refrain from additional purchases of company stock would not violate securities laws, although in the court's view, "plaintiff's theory, would, nonetheless violate the spirit of [those] laws, and at the least, impose a higher standard on ERISA fiduciaries as to Plan purchases of employer stock than would be applied to other stock purchases."\textsuperscript{140} But, ERISA itself imposes these "higher" duties upon plan fiduciaries—they must "act for the exclusive purposes of providing benefits to plan participants,"\textsuperscript{141} with "care and skill";\textsuperscript{142} they must evaluate whether a "particular investment course of action is reasonably designed . . . to further the purposes of the plan," consider "the risk of loss", as well as the "opportunity for gain."\textsuperscript{143} These higher duties would seem to call for, at the very least, that a new investment course of action be adopted.

\begin{itemize}
\item \textsuperscript{135} Id. at *5-6.
\item \textsuperscript{136} Id.
\item \textsuperscript{137} Id. at *22.
\item \textsuperscript{138} Id. at *17.
\item \textsuperscript{139} Id. at *26.
\item \textsuperscript{140} Id. at *26-27.
\item \textsuperscript{141} See text accompanying notes 100 to 104, supra.
\item \textsuperscript{142} See text accompanying note 105, supra.
\item \textsuperscript{143} See text accompanying note 105, supra.
\end{itemize}
In *In re McKesson HBOC, Inc. ERISA Litigation*, plaintiffs were participants in the companies' (McKesson and HBOC) two pension plans. They made similar allegations against both McKesson and HBOC, essentially that they breached their fiduciary duties by establishing and maintaining an investment plan which required that all (at least as it pertained to McKesson) employer contributions be made in company stock; by continuing to maintain substantial portions of the plans' assets in company stock when they were aware of financial and accounting misdeeds which could result in a lower stock value; providing untruthful information regarding HBOC's financial state; and by failing to monitor the decisions of the investment committee.

The complaint, where it asserted breach of fiduciary duty by the failure to divest the plan of the company stock, was insufficient. The defendants argued, and the court accepted, that "they could not have sold company stock without disclosing the financial improprieties," thereby violating insider trading laws. Moreover, a public disclosure of the information prior to trading in the stock would itself have prompted the same sharp drop in stock value. The court stated that "[n]ot even a fiduciary acting in its fiduciary capacity is permitted to engage in insider trading;" that "[f]iduciaries are not obligated to violate the securities laws in order to satisfy their fiduciary duties." This court conceived of the issue as one of causation as opposed to substantive misconduct, and ruled that "even if the defendants breached a fiduciary duty by failing to divest the plan of McKesson stock after the merger, plaintiffs ha[d] not alleged sufficient facts to establish that any damages were caused by such

145. *Id.* Before the merger of McKesson and HBOC, they each maintained employee pension plans. The McKesson plan was a 401(k) and Employee Stock Ownership Plan ("ESOP"). *Id.* at *4. Participating employees contributed deferred compensation and the employer made matching contributions, in the form of company stock or cash, at the company's election, but cash contributions were required "to be converted to company stock as soon as practicable." *Id.* at *4. The HBOC plan provided for employee contributions and matching contributions by the employer. However, unlike the McKesson plan, employees had the right to determine how the funds would be invested, selecting among seven different funds, including the HBOC company stock fund. *Id.* at *5.
146. *Id.* at *7, *11, *41. After the companies merged, McKesson publicly announced that the company had engaged in improper and illegal accounting practices, had materially misrepresented the financial condition of the company and the financial results would be restated downward. As a result, the Company's stock price dropped sharply in value with a consequent rapid decline in the value of the assets held in the McKesson Plan, by more than $800 million. *Id.* at *5-6.
147. *Id.* at *20.
148. *Id.* at *21.
149. See *id.* (citing *RESTATEMENT (SECOND) OF TRUSTS § 166 cmt. a* (1965)) (holding that a trustee is not under a duty to the beneficiary to do an act which is criminal or tortious).
breach.'

In other words, this court believed that the fiduciary can remain silent, indeed conceal from his beneficiary, facts and circumstances detrimental to the plan’s assets, leaving the beneficiary in the dark to continue at his peril. However, unlike the Hull case, this court treated the decision to divest differently from the way it treated the decision to continue to invest in company stock. The court granted plaintiffs’ leave to amend the complaint to include an allegation that the fiduciaries breached their duties and abused their discretion, despite a presumption against diversification (because the plan was an ESOP), in not deviating from the McKesson Plan by continuing to make contributions in the form of company stock, where the facts showed questionable accounting practices which would affect the value of company stock. Would there nonetheless be “communicative content” in a decision by the company to cease matching contributions in stock, and replace them with cash? Would this be a signal to the beneficiary to divest existing holdings? Would the beneficiary have to disclose to her purchaser the change in policy, even though she does not know the basis for it?

B. Duty to Disclose Consistent With Insider Trading Laws

In re Enron Corporation Securities, Derivative & “ERISA”

150. Id. Still, plaintiffs argued that the fiduciaries had options other than violating the insider trading rules that could have averted the loss to the plan, including selling the stock back to the company in a private transaction; “seeking an independent assessment from a financial or legal advisor or resign[ing] in favor of an independent fiduciary, or seeking judicial guidance if the only apparent option for preserving the trust was to deviate from the terms of the trust itself”; or seeking insurance against the loss. Id. at *21-22. The court rejected each of these alternative proposed courses of action as unpersuasive, accepting the defendants’ arguments that retaining independent counsel or an outside fiduciary after learning of the accounting problems would not have avoided that loss, since an independent fiduciary would have been constrained by the same securities law prohibitions that worked against McKesson. Id. at *22. “[R]epurchasing the McKesson stock at the inflated pre-disclosure trading levels . . . would have shifted the loss to McKesson’s other public shareholders”, and it was not certain that the company would have agreed to such a transaction. Id. Nor would insurance have protected the plaintiffs, since the fiduciaries would have been obligated to disclose the accounting irregularities or be liable for insurance fraud. Id. The court found no lawful action that could have been taken to avoid the subsequent loss that occurred after the public disclosure of the accounting problems. Id. at *23.

151. Id. at *21.

152. Id. at *26-27.

To DISCLOSE OR NOT TO DISCLOSE?

Litigation took an entirely different position from those taken in Hull and McKesson. Here, the plaintiffs alleged, among other things, that defendants breached their fiduciary and co-fiduciary duties of prudence, care, and loyalty under ERISA essentially, by (1) "causing, inducing and allowing" investments to be made in Enron stock, when it had material information showing the company was in financial trouble, which would caution against such investments and (2) by failing to disclose those material facts to plan participants.

The first of these allegations suggests two broad questions. Did the defendants fail to exercise independent judgment in not evaluating material information in determining whether to match employee contributions in employer stock despite plan directives? Did they have some discretion in continuing to fund the plan in company stock? The court answered yes to both, finding that an ERISA fiduciary has the duty to follow the documents and instruments governing the plan, but only to the extent that the documents and instruments are consistent with ERISA. Where the two—the provisions of the ERISA policies (i.e., to protect plan assets) and the stated guidelines of the plan—conflict, those of ERISA must be followed.

As to the second allegation, the question is: did the fiduciaries here breach their duties when they failed to make disclosures to plan participants which were material to a determination of the safety of the plan assets? The court repeated what other courts had said, that the trustee is under a duty to communicate to the beneficiary material facts "affecting the interest of the beneficiary which he knows the beneficiary does not know of and which the beneficiary needs to know for his protection," whether or not the beneficiary asks. Here, not only did the defendants fail to make disclosures about this kind of material information (fraudulent accounting, deceitful business practices, the company's "precarious, swiftly deteriorating financial condition"), it also made knowing misrepresentations "intended to induce the plan participants' continued . . .

154. 284 F. Supp. 2d 511 (S.D. Texas 2003). There were five classes of defendants: (1) certain directors and officers of the corporation; (2) committees, trustees, and individuals that administered the three pension plans; (3) the company's accountant, Arthur Andersen, LLP, and some of its partners and employees; (4) the company's outside law firm and some of its partners; and (5) five investment banks. The complaint pleaded causes of action under ERISA, RICO, state common law negligence and civil conspiracy. Id. at 531.

155. Id. at 533, 537.

156. Id. at 548.

157. Id. at 549.

158. Id. In any such case, the court ruled, this kind of determination is not properly made on a motion to dismiss, but rather is only appropriate upon the development of a factual record after discovery. Id. at 534.

159. See id. at 557; see also cases cited supra note 126.

160. Id.
purchase and holding of Enron stock . . ."161 All the while, certain individuals, including the chief executive officer, Ken Lay, were selling large amounts of Enron stock based on the same information.162 On these two bases, defendants breached those standards required of fiduciaries.

Defendants responded by stating that if fulfilling their duties required selective disclosure only to the plan participants of material, non-public information about accounting irregularities and financial improprieties—so that the participants could decide to discontinue the purchase of additional shares or to divest their holdings of Enron stock before a public disclosure, they would be violating insider trading prohibitions under the federal securities laws.163 The court stated:

[i]f a plan fiduciary were to tell plan participants of Enron’s actual financial condition so they could sell at a high price based on this nonpublic information, he would also be violating insider trading laws and he, the plan participants as ‘tippees,’ and the Administrative Committee might be found liable for securities law violations."164

However, this did not excuse defendants from liability under ERISA. The court refused to follow either Hull v. Policy Management Systems Corp.165 or In re McKesson HBOC, Inc. ERISA Litigation,166 attempting to distinguish McKesson on the basis that the ruling there applied to ESOP plans, which by their nature are generally exempt from the duty to diversify and on its face not applicable to the 401(k) plans at issue in Enron.167 However, this was not a valid distinction because one of the plans in Enron was an ESOP; in which case, although there is a presumption that investment in company stock is prudent, the presumption is rebutted by a showing that the failure to diversify was not in the interests of the plan participants.168 The court eventually dismissed McKesson as misguided, finding the defendant’s argument there to essentially be an argument that the fiduciary should both breach his duty under ERISA and, in violation of the securities laws, become part of the alleged fraudulent scheme to conceal Enron’s financial condition to the detriment of current and prospective Enron shareholders, which include the plan’s participants. . . . [T]he statutes should be interpreted to require that persons follow laws, not undermine them. They should be construed not to cancel out the disclosure

161. Id. at 562.
162. Id. at 562-63.
164. Id. at 564.
obligations under both statutes or to mandate concealment, which would only serve to make the harm more widespread; the statutes should be construed to require, as they do, disclosure by Enron officials and plan fiduciaries of Enron’s concealed, material financial status to the investing public generally, including plan participants, whether ‘impractical’ or not, because continued silence and deceit would only encourage the alleged fraud and increase the extent of injury.  

Moreover, the court found that:

a fiduciary’s duty of loyalty should also not be construed to require him to enable and encourage plan participants to violate the law, i.e., to sell their stock at artificially high prices to make a profit or avoid loss before disclosure of Enron’s financial condition was made public.

The court seemed to believe that the ERISA fiduciary’s duty to disclose would encompass such material inside information, suggesting that the plan assets are threatened by continuing the existing investment course of action, but that the insider trading laws preclude the plan participants from using the information to trade without public disclosure. However, this would only be the case if these plan participants owed duties to other shareholders or to the corporation (Chiarella), or if they received the information from someone with such a duty who disclosed it improperly (Dirks). However, in Dirks, disclosure by an insider for purposes of

169. In re Enron, 284 F. Supp. 2d at 565. The court believed that any damage suffered by plan participants as a result of a drop in price before they could make a profit or avoid a loss “would not be the fault of the plan fiduciary but of the underlying alleged fraudulent Ponzi scheme, and the corporate officials who participated in it.” Id.

170. Id. The court concluded, “A trustee has no duty to violate the law to serve its beneficiaries.” Id. (citing RESTATEMENT (SECOND) OF TRUSTS § 166, cmt. a). Indeed, the court explained, an ERISA fiduciary cannot be held liable as an insurer of the value of plan assets, even where the value is reduced as a result of fraud or manipulation; rather, a fiduciary only has a duty to satisfy the prudent man rule, which provides immunity from liability if the fiduciary “performs the necessary investigations and provides accurate information in accordance with it.” Id. at 565-66. The court placed reliance upon the Department of Labor’s interpretation of ERISA and its interface with the securities laws, which rejected the McKesson court’s interpretation. The Department of Labor, in an amicus curiae brief, suggested practical ways to resolve the alleged tension between ERISA and the federal securities statutes: (1) disclosure of “the information to other shareholders and the public at large” or “forcing Enron to do so”; (2) eliminating Enron stock as a plan investment option and as the form of the employer match under the Savings Plan; (3) “alert[ing] the . . . regulatory agencies, such as the SEC and the Department of Labor, to the misstatements.” Id. at 566. But none of these courses would have averted, indeed they would have precipitated, the harm that results from public disclosure of the misconduct, which causes the stock price to plunge.


bringing fraud to light, was not an improper disclosure where the party making the disclosure, did not desire, nor receive, an improper personal benefit. As such, tippees from the analyst who was tipped, could trade with impunity.173

Surely, the company would not want to make a public disclosure of the fact of $25 billion in liabilities.174 Yet, a Form 8-K might have been required where this number would mean a material change in assets. Still, until a Form 8-K is filed, this court believed that the company’s ERISA fiduciary, to the extent it knows of the underlying facts, may not give advance notice to plan participants to enable them to beat the market. The court stated, “[l]ike any other investor, plan participants have no lawful right, before anyone else is informed of Enron’s negative financial picture, to profit from fraudulently inflated stock prices or to avoid financial loss by selling early before public disclosure.”175

Is the employee-shareholder “any other investor”? Perhaps not, since whether she funds her retirement plan with Enron stock or cash or another company’s stock was not up to the employee (as the plan required funding “primarily” in company stock, and this is what Enron did). The employees wholly lacked the discretion, the autonomy of a voluntary market participant, but arguably had the most to lose by a decision made by the very person engaging in conduct calculated to compromise the investment.176

The court in In re Worldcom, Inc. ERISA Litigation177 followed the reasoning of Enron and held that plan fiduciaries had a duty to make disclosures to plan participants as well as to the public.178

Plaintiffs complained that defendants breached their fiduciary duty to act with prudence, among other things, when they “continued to offer Worldcom stock as an investment alternative under the plan” and failed “to investigate and monitor the plan’s investments, including its investment in Worldcom stock”, then divest the plans of Worldcom stock based upon information discovered.179

Defendants sought to avoid liability on the theory that they had no discretion as to whether an investment in Worldcom stock should be

174. See text accompanying note 4, supra.
176. See text accompanying notes 100 to 107 and 115 to 117, supra on fiduciary duties of care and loyalty.
178. Under the plans, participants had a choice of several different funds in which to invest, including Worldcom stock. Id. at 753, 754. Participants had discretion to make allocations among the investment options with the right to “reduce or eliminate their investments in Worldcom stock at any time.” Id. 754.
179. Id. at 763-64.
offered to employees because the plan description offered it and plan participants exercised independent control over the assets in their accounts.\textsuperscript{180} The court ruled that ERISA does not shield fiduciaries from liability in these circumstances if the investment decisions were "not independent," if a plan fiduciary has concealed material non-public facts regarding the investment from the participants unless the disclosure would violate the law.\textsuperscript{181} The court further held:

[t]o the extent, therefore, that any plan fiduciary had responsibility to decide or present it [sic] views on the wisdom of the investment options, it would have been a breach of that duty not to alert Worldcom of the need to eliminate, or at least, to consider eliminating Worldcom stock as one of the investment alternatives.\textsuperscript{182}

That the plan here was an ESOP, in which employees had the opportunity to invest solely in the employer's stock, did not relieve a fiduciary from liability for continuing to offer such an investment where subsequent events not anticipated by the settlor of the trust made continued investment in the company's stock imprudent.\textsuperscript{183} The offering of employer stock as an investment option was a fiduciary, not a business, decision.

Plaintiffs also alleged that the chief executive officer breached his fiduciary duty to monitor the plan's other fiduciary and his duty of loyalty by the failure to disclose to the other fiduciaries material facts he knew or should have known about the financial condition of the company.\textsuperscript{184} Defendants responded that the duty to disclose arises under the federal securities laws and not under ERISA. Allowing the plaintiffs to state an ERISA claim for failure to disclose information, if material, would "impermissibly extend[] the reach of ERISA and impose[] on corporations a duty of continuous disclosure not contemplated by the well-developed regime of securities regulation."\textsuperscript{185} Defendants argued further that plaintiffs' allegations, if accepted, would "impose[] a continuous duty of disclosure on ERISA fiduciaries that [would] overwhelm[] the federal securities law disclosure requirements and compel fiduciaries to violate the prohibitions against insider trading."\textsuperscript{186} In other words, the defendants said, the ERISA fiduciary/insider, upon discovery of material information affecting the value of company stock as an investment option, is confronted with two conflicting options: disclose the material information to plan

\textsuperscript{180} Id. at 764, 764, n.12 (citing 29 C.F.R. § 2550:404c-(c)(2)).

\textsuperscript{181} Id. at 764.

\textsuperscript{182} Id.

\textsuperscript{183} Id. (citing Moench v. Robertson, 62 F.3d 553, 571, 572 (3d Cir. 1995)).

\textsuperscript{184} Id. at 765.

\textsuperscript{185} Id.

\textsuperscript{186} Id. at 766.
participants before a public disclosure, thereby violating prohibitions on the insider trading by suggesting that they divest stock based upon this material information, or make a public disclosure, thereby exposing the plan participants to harm when the market reacted to the adverse information.\textsuperscript{187}

The court rejected defendants’ argument, first finding that when the chief executive officer wore his ERISA “hat” he was required to “act with all the care, diligence, and prudence required of ERISA fiduciaries,” meaning that he had a duty to disclose to all the investment fiduciaries material information he had regarding the prudence of investing in Worldcom stock.\textsuperscript{188} “[H]e is not assumed to have forgotten adverse information he may have acquired while acting in a corporate capacity.”\textsuperscript{189}

The court further rejected the suggested tension between the federal securities laws and ERISA that would cause dismissal of the claim, although the reasoning is not convincing. The court explained that ERISA fiduciaries are forbidden to convey false information to plan participants “when a prudent fiduciary would understand that the information was false.”\textsuperscript{190} And, nothing in the plaintiffs’ claim “require[d] ERISA fiduciaries to convey non-public material information to plan participants.”\textsuperscript{191} Instead, what was required was that “any information that is conveyed to participants be conveyed in compliance with the standard of care that applies to ERISA fiduciaries,”\textsuperscript{192} that is, that it be truthful and complete.\textsuperscript{193} However, plaintiffs alleged that defendants made misrepresentations about the soundness of Worldcom stock and failed to fully and accurately disclose to them, the stock’s infirmities, causing them to make and maintain their investments.\textsuperscript{194} But the disclosure they maintain should have been made, would entail all material, even non-public information (that is, the truth), the absence of which would cause harm to the plan beneficiary. The court did not directly respond to this point, saying simply that “the existence of duties under one federal statute does not, \textit{absent express congressional intent to the contrary}, preclude the imposition of overlapping duties under another federal statutory regime.”\textsuperscript{195} But, is there \textit{express congressional intent to the contrary}? Under ERISA, Congress imposed high standards of care and loyalty upon the fiduciary (to

\begin{itemize}
\item \textsuperscript{187} \textit{Id.}
\item \textsuperscript{188} \textit{Id.} at 765.
\item \textsuperscript{189} \textit{Id.} at 766.
\item \textsuperscript{190} \textit{Id.} at 767.
\item \textsuperscript{191} \textit{Id.}
\item \textsuperscript{192} \textit{Id.}
\item \textsuperscript{193} The defendants, having spoken in SEC filings, “had a duty under federal securities laws to correct any prior material misrepresentation, when it became aware of the falsity.” \textit{Id.} at 767.
\item \textsuperscript{194} \textit{Id.} at 766.
\item \textsuperscript{195} \textit{Id.} (emphasis added).
\end{itemize}
act for the "exclusive purposes . . .", "solely in the interests of the plan participants") and went on to provide that the express standards imposed were to be expanded by common law principles, which have been interpreted to impose the "highest duties" upon plan trustees. It seems that requiring disclosure and meaningful advice to plan participants about the wisdom of investing in company stock, is necessary for the achievement of the congressional aim of protecting employee rights in pension plans. Otherwise, plans funded primarily by company stock (the value of which the company knows to be seriously compromised by illegal, fraudulent or reckless conduct) would become complete frauds.

Other courts have followed in lockstep fashion the earlier rulings of other courts, such as Enron and Worldcom, without much analysis of the issues. For example, in Rankin v. Rots, plaintiffs, plan participants, alleged against several ERISA fiduciaries that they breached their fiduciary duty by, among other things, continuing to invest in and promoting company stock when they knew of a substantial risk of doing so and failing to provide all material information about the company's serious financial troubles, which severely threatened plan assets. The defendants moved to dismiss arguing, among other things, that "to the extent they had any fiduciary duties with respect to the disclosure of information, they could not have, as a matter of law, breached them." Such disclosure of non-public information about the company, they maintained, would have violated securities laws against insider trading.

The court relied upon the ruling in Worldcom, essentially quoting large sections from that decision, without any explanation why it was the better view among the cases addressing the issue. The court simply believed that the duties under ERISA and the securities laws could exist and be fulfilled concomitantly.

In In re CMS Energy ERISA Litigation, plaintiffs were plan participants that sued their employers and certain directors and officers of the companies, alleging, inter alia, breach of fiduciary duty under ERISA in failing to manage the plan assets with loyalty and prudence, to

197. Id. at 863, 864, 867.
198. Id. at 873.
200. Rankin, 278 F. Supp. 2d at 875-76.
201. Id. at 874-75.
203. The Plan allowed employees to direct contributions into an investment of their choosing from several options, including Fund CS, which consisted primarily of CMS stock. Id. at 902. Another part of the plan, provided for employer matching contributions up to 3% of an employee's salary to be directed into the participating employee's ESOP account. Incentive contributions were also sometimes contributed to employees' ESOP accounts. Id. Both the matching employer contributions and incentive contributions were made primarily in company stock. Id.
provide full and truthful information to plan participants, failing to oversee
the activities of the plan’s investing fiduciaries, and causing the plan to
engage in a prohibited transaction, that is, by acquiring CMS stock for the
plan at a price greater than adequate consideration.\textsuperscript{204}

Plaintiffs alleged that CMS engaged in “round-trip” electricity trades,
whereby purchases and sales of electricity occurred simultaneously, with
the same parties and at the same price. These trades gave the appearance of
an increased volume of buying and selling and increased revenues and
expenses by $4.4 billion, but in truth they had no economic substance.
They were contrary to generally accepted accounting practices and
“rendered the financial statements materially false.”\textsuperscript{205} When these trades
came to light and an investigation commenced, the price of CMS stock
dropped significantly.\textsuperscript{206} Plaintiffs maintained that the truth about these
trades should have been disclosed to plan participants.

Defendants argued that they invested employee contributions “exactly
as required by the explicit terms” of the plan and were not free to reject a
choice made by the plan participants.\textsuperscript{207} The court accepted plaintiffs’
argument in reply that to the extent that the plan provided for funding
primarily, although not exclusively, in company stock, the defendants had a
fiduciary duty to consider the wisdom of that decision; that they had a duty
under ERISA not to follow the plan if to do so would mean acting
imprudently.\textsuperscript{208} Therefore, defendants could be liable for continuing to
fund the plan with company stock, although the court held differently on
the allegation that they should have disclosed information for purposes of
divestment.

Defendants argued that they were precluded from obtaining inside
information about CMS’ questionable trading and lawfully using such
information to benefit plan participants because that would have amounted
to “tipping” as proscribed by securities laws.\textsuperscript{209}

The court relied on \textit{Rankin v. Rots},\textsuperscript{210} an opinion by a court in its
jurisdiction, which quoted extensively from \textit{Worldcom}, accepting
defendants’ argument.\textsuperscript{211}

\textsuperscript{204} Id. at 903.
\textsuperscript{205} Id. at 902-03 (citations omitted) (internal quotation marks omitted).
\textsuperscript{206} Id. at 903.
\textsuperscript{207} Id. at 913.
\textsuperscript{208} Id.
\textsuperscript{209} Id. at 914. The defendants relied on \textit{Hull v. Policy Management Systems Corp.}, No.
3:00-778-17, 2001 U.S. Dist. LEXIS 22343, at *26 (D.S.C. Feb. 9, 2001), which held that a
fiduciary does not breach an ERISA fiduciary duty by failing to disclose to plan participants
material non-public information, which would violate the insider trading laws.
\textsuperscript{211} CMS Energy, 312 F. Supp. 2d at 915 ("existence of duties under one federal statute
does not, absent express congressional intent to the contrary, preclude the imposition of
In *Hill v. BellSouth*, the court endeavored to narrow the disclosure duty to cases presenting special circumstances. The court, however, was not successful, since the circumstances presented there occur in virtually every case. The court otherwise did not resolve the insider trading dilemma. There, plaintiffs, plan participants and beneficiaries sued defendants, the company sponsoring the plan and various officers and directors alleging breach of fiduciary duty under ERISA. A year earlier, the company erroneously accounted for certain consumer accounts as realized revenue. These inaccurate revenue statements were reported both to the SEC and to the public through a series of SEC filings and press releases. Later, the company issued a press release revealing the overstatement to be $163 million, or about $.09 per share. The release was followed by an SEC filing.

Plaintiffs alleged that they invested in company stock based upon communications from defendants in which they discussed the advantages of company stock as a plan option, but omitted to provide information that was later reported in SEC filings which revealed the risks in continuing this investment. Plaintiffs maintained the information should have been provided to them before the public SEC filing.

Defendants moved to dismiss arguing that they had no affirmative duty to disclose information not specified by ERISA; indeed to do so, revealing “‘inside information’ to Plaintiffs might be a violation of [the] Rule 10b-5” prohibitions against insider trading. Defendants argued also that there was no proximate cause between their alleged failure to disclose because even if that information should have been disclosed, upon its public release the market would have immediately adjusted the stock price downward, and Plaintiffs could only have sold at the lower price. However, discreet disclosures only to plan participants would be different. According to scholars on the issue, trading based on non-public information communicates to the market which leads to a price adjustment, but the initial trading by plan participants (until the market reacted) would

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overlapping duties under another federal statutory regime.”) (internal indentation omitted) (quoting *Worldcom*, 263 F. Supp. 2d at 766-67).


213. *Id.* at 1364. Under the plan, participants contributed a portion of their salaries to the plan and had the right to determine in which of the plan’s investment options those contributions would be invested, one of which was the BellSouth Stock Fund, invested in shares of company’s stock. *Id.* Matching employer contributions were made in company stock. *Id.* Initially, employees were prohibited from transferring matching contributions to other plan funds, but the plan was later modified to permit this. *Id.*

214. *Id.* at 1365.

215. *Id.* at 1365.

216. *Id.* at 1366.

217. *Id.*

218. See text accompanying notes 56 to 65, *supra.*
have enabled the plan participants to minimize their losses in the meantime. Though a mass dumping of company stock would seem to more quickly inform the market about the value of the stock sold.

Nonetheless, the court accepted the defendant's argument that the duty to disclose was limited, but it did not address the insider trading issue. Pointing to *In re Enron*, 219 the court found a willingness among courts "to find an affirmative fiduciary duty to disclose information beyond the traditional duties to disclose specified in the statute or the common law obligation to respond to specific requests from plan participants or beneficiaries." 220 However, the court cautioned, "this new affirmative duty to disclose has only been imposed in 'special circumstances with a potentially "extreme impact" on a plan as a whole, where plan participants generally could be materially and negatively affected.'" 221 Thus, this court did not recognize a general duty to disclose the financial details of the business. 222 Nonetheless, the court accepted the plaintiff's allegations as true and the defendant admitted that certain investments were risky, that the company was losing money in an area in which the company was alone among its peers, and that revenues had been inflated by accounting misdeeds. 223 These facts would have signaled to the prudent fiduciary that continued investment in company stock was not wise. 224 In addition, during this period, the defendants kept encouraging employee investment in the company stock, which by then already represented 40% of the plan's assets. 225

The court otherwise did not reach the insider trading assertions made by defendants; that divesting their funds of company stock based upon the disclosed information would have been illegal.

In *In re Westar Energy, Inc., ERISA Litigation*, 226 plan participants sued the corporate sponsor along with individual fiduciaries 227 alleging, *inter alia* violations of the duty of prudence and loyalty 228 when the

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221. Id. at 1370 (citing *In re Enron*, 284 F. Supp. 2d at 559).
222. Id. at 1369.
223. Id.
224. Id. at 1368, 1369.
225. Id.
227. The defendants included the corporation sponsor, the Investment and Benefits Committee, the administrator of the Plan, David D. Wittig, the former chief executive officer, and nine individual members of the Committee. Id. at *4.
228. Id. at *5. The pension plan matched employee contributions up to a maximum of 50% of the first 6% of the participant's contributions, which were made in either common stock or cash. Id. at *7, *8, n.9. For most of the life of the plan, the company matched contributions with company stock. In fact, until just before the suit was instituted, company
defendants misrepresented or failed to disclose the facts regarding certain risky and burdensome enterprises and restructuring, company compensation policy, and accounting irregularities.\textsuperscript{229} Specifically plaintiffs complained that the company embarked on acquisitions of unregulated businesses, acquiring three companies at a price exceeding $650 million, which resulted in a substantial decline in the company’s net income (by some $140 million) and a substantial increase in debt obligations (by some 416\%).\textsuperscript{230} In addition, the plaintiffs claimed that the actions the company undertook resulted in a restructuring scheme which saddled the company with a capital structure of 93\% debt, all the while the company made public statements that the restructuring would be beneficial for the company, knowing that events and occurrences showed otherwise.\textsuperscript{231} In addition, the company permitted a variety of executive compensation schemes and self-dealing transactions calculated to drain corporate resources.\textsuperscript{232} It seems that the kinds of information plaintiffs maintained should have been disclosed to them was the kind that should be included in one or all of the company’s periodic reports required by the federal securities disclosure laws.\textsuperscript{233} But these would only be filed at the end of the year or quarter, or sooner, by a form 8-K, though the precise timing would be somewhat within the corporation’s discretion (particularly in determining when a reportable event had occurred). Plan participants, though, maintained that the information should have been discreetly disclosed to them first to avoid those losses that resulted once the public became aware of these reckless actions.

Defendants asserted, among other things, that to make the disclosures plaintiffs identified, would have required them to violate securities laws on insider trading and that ERISA cannot be construed to “invalidate, impair, [or] supersede any law of the United States.”\textsuperscript{234} The court interpreted the defendant’s argument as one involving “the theory of ‘inevitable loss,’ that any actions they might have taken would not have prevented the loss of stock value.”\textsuperscript{235} At the same time, it rejected that theory.\textsuperscript{236} The court

\begin{itemize}
  \item matching contributions were effectively locked into Westar stock, since matching contributions were not permitted to be transferred into other investment accounts. \textit{Id.} at *8.
  \item This restriction did not apply to participants age 55 and older. \textit{Id.} at *8, n.13. The Investments and Benefits Committee had the power to adjust the “number and type of Investment Funds . . . from time to time.” \textit{Id.}
  \item \textsuperscript{229} \textit{Id.} at *28-31,*43.
  \item \textsuperscript{230} \textit{Id.} at *28.
  \item \textsuperscript{231} \textit{Id.} at *29-30. These events and occurrences included the criticism by the Kansas Corporation Commission and other experts, the rejection of a rate increase, and an actual decrease in rates. \textit{Id.} at *29.
  \item \textsuperscript{232} \textit{Id.} at *30.
  \item \textsuperscript{233} \textit{See note 21, supra on periodic reporting required of regulated companies.}
  \item \textsuperscript{234} \textit{Id.} at *50.
  \item \textsuperscript{235} \textit{Id.} at *50.
\end{itemize}
simply chose to follow *Enron*, holding that plan fiduciaries must follow both laws: there must be disclosure before trading, "whether impractical or not, because continuing silence and deceit would only encourage the alleged fraud and increase the extent of injury."\(^{237}\)

In the case of *In re Electronic Data Systems Corp. "ERISA" Litigation*,\(^{238}\) plan participants brought suit alleging breach of fiduciary duty by failure to disclose the great risks associated with some of the company’s "mega-deals", i.e., "multi-year information technology outsourcing contracts negotiated for over $250 million each."\(^{239}\) These risky ventures had an adverse effect on plaintiffs’ retirement plan,\(^ {240}\) including a loss in value of EDS stock upon announcement by the company that it would fall short of its expected earnings per share by some seventy percent.\(^ {241}\) Upon the announcement, the EDS "stock price plummeted over [50%], wiping out some $8 billion in market value, including significant [p]lan value for shares held by [p]lan participants and beneficiaries in the EDS stock fund."\(^ {242}\)

Plaintiffs alleged that

[d]efendants breached their fiduciary duties under ERISA by continuing to invest [p]lan funds in EDS stock despite knowledge that the stock was an inherently risky investment[;] by failing to [p]rudently manage plan investments[;] by continuing to invest [p]lan assets in high-risk EDS stock[; by] misle[ading] [p]laintiffs . . . by issuing false and misleading Summary Plan Descriptions . . . to [p]lan beneficiaries[; and by] fail[ing] to disclose inherent risks in EDS’ IT outsourcing contracts and in its association with the airline industry.\(^ {243}\)

As to plaintiffs’ argument that defendants failed to provide full and truthful information and that they otherwise misled plaintiffs as to EDS’s financial condition, defendants argued that even if they had a duty to

\(^{236}\) Id. at *53-54. The court also questioned the propriety of the “inevitable loss” defense to causation where defendants knew of the misrepresentations for some period of time, but took no action which only prolonged and exacerbated the loss. Id. at 54-55.

\(^{237}\) Id. at *53-54.

\(^{238}\) 305 F. Supp. 2d 658 (E.D. Tex. 2004).

\(^{239}\) Id. at 661. While the company boasted of the value of these “mega-deals” on the company’s revenues, it did not disclose that the deals carried great risks. Id. at 662.

\(^{240}\) Under the plan, employees contributed up to 20% of their income into one or more various investment options, among which was the EDS Stock Fund, comprised almost entirely (99%) of EDS stock. The employer’s matching contributions were in the form of EDS stock. Id. Two years before the company announced it would not make its financial projections, the EDS Stock Fund represented nearly 21 percent of total plan assets. Id. at 662.

\(^{241}\) Id. at 662.

\(^{242}\) Id. at 662-63.

\(^{243}\) Id. at 663 (footnote omitted).
provide information to plan participants (which they did not concede), to
fulfill that duty would have required that they violate insider trading laws,
since the information plaintiffs sought was corporate information and not
publicly available.244 The court agreed with defendants that fulfilling
fiduciary duties does not require a violation of law. Nothing in ERISA
“impos[es] a so-called ‘duty to tip.’”245 However, the court ruled that
[d]efendants would not be allowed to use the securities laws as a shield
against liability under ERISA.246 The court found the treatment of the same
issue by the court in Enron to be persuasive—that ERISA and the
Securities Act could be read and applied in harmony, requiring disclosure
of material information to plan participants, but also disclosure to the
investing public, since silence only compounds the injury.247

But injury to whom? Silence as to the plan participants causes injury
as they continue to invest their funds in stock with questionable value.
Disclosure, enabling divestment, avoids that injury. Silence as to open
market traders causes injury when the trader buys that stock at a higher
price than if the market had been informed of the negative, price adjusting
information. But a public announcement will enable open market traders to
avoid losses altogether, by deciding not to purchase in the first place,
leaving employees holding the worthless stock. Therefore, the only losers
would be the employees.

C. Skirting the Issue

Some courts, rather than dealing with the issue head on or taking a
position that would be clearly disingenuous, have skirted the issue
altogether. In In re Williams Companies ERISA Litigation,248 plaintiffs,
pension fund participants, alleged that the plan fiduciaries breached their
duties by failing to disclose that the company “was operating below
company sponsored expectations”; that is, “it was impossible for [the
company] to meet its financial goals . . . without substantially revising
estimates to include massive cap-ex spending reductions,”249 information
which suggested that investment in the company stock was imprudent.250

244. Id. at 673.
245. Id.
246. Id. at 673.
247. Id. at 673 (citing In re Enron Corp. Sec., Deriv. & “ERISA” Litig., 284 F. Supp. 2d
511, 565 (S.D. Tex. 2003)).
249. Id. at 1336.
250. The plan permitted, but did not require, employees to invest a portion of their salary
in a range of options, including company stock. Id. at 1331. Indeed it allowed up to 100%
of assets to be invested in company stock. Id. at 1332. The plan “promoted employee
ownership” through the company’s voluntary matching contribution, which was “invested
The defendants moved to dismiss on the grounds (among others) that:

(1) they had no duty to disclose material non-public financial information and, in any event, any such disclosure would have constituted a violation of federal securities laws; (2) they had no duty to eliminate [company stock] as an investment option and, even if they did, Section 404(c) of ERISA insulates them from liability, that section exempting the plan from the diversification requirement; and (3) they had no duty to avoid any alleged conflict of interest.\(^\text{251}\)

The court rejected all three arguments, although it did not give separate reasons for each defense, finding that "parsing of the alleged actions by the Committee defendants [would not be] useful at this stage of the litigation."\(^\text{252}\) The court specifically found that the plan gave the Investment Committee the discretion to recommend investment options to the Benefits Committee and the Benefits Committee in turn was given the discretion to delete or establish an Investment Fund.\(^\text{253}\) Since the plan did not require that company stock be offered as an investment option, "any plan fiduciary had a duty to decide or present its views on the wisdom of investment options."\(^\text{254}\) Therefore, it would have been a breach of that duty not to remove, or at a minimum consider the removal of company stock as an investment option, given the devastating facts about the company's financial condition.\(^\text{255}\) In the court's view, "the duty to disclose, the duty to eliminate inappropriate investment options and the duty to avoid a conflict of interest were in effect different aspects of a single fiduciary duty."\(^\text{256}\) Indeed, the court found that "had the Investment Committee recommended removing company stock from the list of available investment options, based upon its alleged knowledge that company stock was wrongfully inflated, the alleged damage would not have occurred."\(^\text{257}\) The court otherwise did not address the insider trading prohibition asserted by the defendants, leaving it unclear whether the fiduciary, after having considered the prudence of company stock as an investment, would have had to disclose publicly the basis of this conclusion so that plan participants

solely” in the company’s common stock, \textit{id.} at 1333, and allowed participants to diversify out of the company match and certain accounts “when their employment was terminated or upon reaching a designated age—initially 55, later lowered to 50.” \textit{Id.} at 1334. As it stood, the plan participants had no choice but to fund their pension plans largely with company stock.

\(^{251}\) \textit{Id.} at 1340.
\(^{252}\) \textit{Id.} at 1343.
\(^{253}\) \textit{Id.}
\(^{254}\) \textit{Id.}
\(^{255}\) \textit{Id.} (citing \textit{In re Worldcom, Inc.}, 263 F. Supp. 2d 745 (S.D.N.Y. 2003)).
\(^{256}\) \textit{Id.}
\(^{257}\) \textit{Id.} at 1342.
could divest.

In *Xcel Energy, Inc., Securities, Derivative & “ERISA” Litigation*, plaintiffs were plan participants who alleged that defendants failed to advise plan participants of substantial risks to Xcel stock associated with certain contracts, “round-trip trading” and certain cross-default contract provisions, or otherwise take action such as diversification to protect plan assets. They argued that as plan fiduciaries, defendants had an obligation to invest plan funds with prudence and for the sole benefit of plan participants. They maintained that defendants also had a duty to “monitor individuals assigned fiduciary duties, investigate matters posing significant risk to the plans, and disclose material adverse information to plan participants.” When the cross-default provisions became public, the stock price of Xcel dropped precipitously (by almost 36%). While the court agreed with defendants that parts of the plan—that ESOP funds be invested in company stock and that the company stock be included as an investment option—were plan design decisions, not subject to ERISA’s fiduciary standards, the defendants had misread plaintiffs’ allegations. The court pointed out that plaintiffs complained about the failure to disclose “material adverse information about the true value of the stock.” This was a breach of fiduciary duty.

Defendants argued further that they could not have disclosed the adverse information to plaintiffs and not to the investing public so that plan participants could trade their stock in light of the prohibitions against insider trading. On this argument, the court followed the *Enron* line of cases refusing to allow ERISA plan fiduciaries to put up the securities laws as a bar to liability for breaching ERISA fiduciary duties. Thus, while the court held that defendants had a duty to make disclosures of these adverse conditions to plan participants, it did not expressly state that the

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259. *Id.* at 1174. Under the ESOP, investments were primarily in company stock. Participants contributed a portion of their pay to various investment funds, including an Xcel stock fund. The company made matching contributions to the ESOPs either in Xcel stock or cash which was to be invested in Xcel stock. In the non-ESOP component, contributions were either in cash or company stock to the particular investment selected by the employee. *Id.* at 1173.
260. *Id.* at 1174.
261. *Id.*
262. *Id.*
263. *Id.*
264. *Id.* at 1181.
265. *Id.*
266. *Id.*
plan participants could not use this information for purposes of divesting, although by adopting the reasoning of *Enron*, that would be the logical conclusion.

VI. RESOLUTION OF THE CONFLICT

The conflict is this. Some courts rule that a plan fiduciary has no duty to disclose to plan participants facts of financial misconduct or other adverse circumstances which might influence the decision of the plan participant to dispose of company stock if such disclosure is not a public one and the information would be used for trading. Other courts impose liability upon plan fiduciaries for failing to make the same disclosure to plan participants, but also impose a duty upon the fiduciary not to violate insider trading laws, by enabling trading, thereby requiring a public disclosure before any trading occurs.

How can these cases be harmonized? How can the affirmative duties imposed by ERISA on a plan fiduciary be reconciled with the prohibition on insider trading under the securities laws? Should the plan fiduciary who is a corporate insider be required or permitted to make discreet disclosures to plan participants of information having a negative impact on the value of company stock as an investment, allowing divestment of that stock? Here are some relevant considerations.

The prohibition on insider trading is not absolute. Instead, it binds only those who have a duty, either to those with whom the possessor of the information is trading, to the corporation whose shares are being traded, or to the source of the information. Thus, one who obtains information through independent research, fortuitously, and even by theft, is free to trade to the disadvantage of the other party. With this is the reflection of the idea that the securities laws cannot and should not strive to equalize all risks in the market; there are some informational disadvantages that are unavoidable. And, the Supreme Court has held that liability for trading on non-public information does not arise “merely from one’s ability to acquire information because of his position in the market.”

How is the plight of the employee-shareholder similar to the fortuitous possessor of information? It seems that they are not. Instead, they seem in no different position than the insider in *O’Hagan*, who obtained information by virtue of his fiduciary relationship to the source of the information and traded on that information in breach of a duty owed to that source. However, where the plan fiduciary discloses information to the plan participant, surely it is done in fulfillment of a duty imposed by law

for the purpose of allowing the plan participant to rethink an existing investment course of action. Thus, the plan participant, if he trades, would not be acting in breach of a duty owed to the source of the information. But if the information is confidential and the source had a duty not to disclose it, then the plan participant might be liable derivatively for trading if the source of the information received some improper personal benefit in exchange.270 Under the Dirks analysis, it is arguable that a disclosure to the plan participants would not be actionable where the ERISA fiduciary does not personally benefit by the disclosure, but is only acting to protect plan beneficiaries.271 Yet, the broad definition given to personal benefit by the Supreme Court, including a reputational advantage which might translate into a pecuniary benefit in the future, would suffice. Does the ERISA fiduciary obtain such an advantage from protecting the assets of the plan? The court did not find such a benefit in Dirks, where the insider tipped an analyst, who alerted clients, to the “massive fraud”272 taking place in the corporation whose shares were traded.273

Even if the corporation discloses the information to the plan fiduciary without restrictions on what could be done with it and plan participants trade, is there such unfairness to other market traders as would greatly affect the integrity of the market?274 Would Regulation FD require the corporation to make a public disclosure?275 The case that this sort of trading by plan participants is not unfair to parties on the other side of the trades is hard to make. Yet, Chiarella held that not all instances of unfairness amount to fraud.276

The rulings from the courts supposedly requiring disclosure to both plan participants and to the public are not satisfying; they leave millions of innocent employee-investors subject to harm and may impose onerous

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270. Id. at 652, 665 n.11 (describing what the misappropriation theory covers and “uphold[ing] the misappropriation theory on the basis of [section] 10(b) [of the Securities Exchange Act of 1934]”).

271. Dirks v. SEC, 463 U.S. at 664 (holding that, regardless of “whether an insider personally benefits from a particular disclosure . . . there must be a breach of the insider’s fiduciary duty before the tippee inherits the duty to disclose or abstain.”)

272. Id. at 651-52 (citation omitted) (internal quotation marks omitted).

273. Cf id. at 651-52, 665, 667 (holding that Dirks had “no pre-existing fiduciary duty to [the corporation’s] shareholders,” and that he “had no duty to abstain from use of the inside information that he obtained.”)

274. Since the insiders would not themselves be trading (the original “unfairness” rationale) some other justification is in order. The original concern seemed to focus more upon the undue enrichment by the insiders as opposed to the losses to the party on the other side, since unless the insiders were trading, no disclosure needed to be made and information obtained other than through a corporate position could be used to trade without liability. See discussion of Chiarella and soundness of the prohibitions on insider trading, at text accompanying notes 54 to 73, supra.

275. See note 53, supra, for discussion of Regulation FD.

disclosure duties on corporations that far exceed the requirements of the Securities Acts and ERISA. ERISA and the Securities Acts serve discrete aims: ERISA to encourage and safeguard employee retirement plans through stringent fiduciary duties requiring prudent and loyal management, and the Securities Acts to encourage periodic disclosure to ensure informed investment decisions.

It is a better starting point to consider the extent to which the plan participants had actual control over the investment of plan assets. If they do not, then requiring a plan fiduciary to disclose material non-public information will help avoid injury to one who is as innocent as the person on the other side of the trade. In virtually all of the cases discussed here, the employees were either encouraged to invest in company stock or the employer’s matching contributions were almost entirely in company stock, with little discretion or judgment being exercised by the fiduciaries as to whether this was a prudent course, despite information suggesting otherwise. It is important to consider whether persons on the other side of the trade assume a degree of risk in investing in the stocks to start with, and whether research could have produced the non-public information, or at least some warning signs. The securities laws should not aid those who knowingly engage in a crooked game and fail to exercise a certain vigilance. At the same time, employees have limited say as to whether their retirement benefits take the form of cash or company stock. It is also important to consider what is at stake in these investments. Does the interest in protecting pension plan benefits outweigh the possible harm to shareholders dealing without equal information in an anonymous market?

So solve this problem, Congress could require that no plan fiduciary be an insider of the corporation. However, this would only result in less information than is currently available. The possible losses to pensioners might also be reduced by stricter limits on the extent that pension plans can be funded with company stock and rules enabling the sale of company stock at will.

The best approach would allow for the fiduciary and insider obligations to coexist. While not permitting the corporate insider to make non-public disclosures to facilitate trades by the employee-shareholders, courts could read the ERISA fiduciary duty to require him or her to advise the employees that further investment in the company would not be wise, but without stating why, if that would reveal non-public corporate information, and to urge the company to match contributions in other than company stock. This decision not to fund pension plans with company stock would not be a trade and therefore not prohibited by insider trading laws. But would this nonetheless send signals to the market, if it were announced that the company would no longer offer its stock as an investment option to employees? Would the ERISA fiduciary have to
make a public announcement of a change in investment policy? Could the employees then trade their existing holdings? Even if sophisticated investors would surmise that something unsavory is occurring and bid lower, or start selling off shares, causing some decline in the market price of the company stock, this approach on handling the dual duties owed by insiders and ERISA fiduciaries would go a long way toward reducing potentially devastating losses to pensioners.