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THE CHANGING WORLD OF EMPLOYEE BENEFITS

MARIA O’BRIEN HYLTON*

INTRODUCTION

When I graduated from law school in 1985, there were no courses offered in employee benefits law. Nor, as near as I can recall, was ERISA ever discussed in any of the labor and employment classes I took. There was no mention in the introductory labor law course or in other classes about employment discrimination, union organizing, and employment arbitration. Now, in contrast, many law schools include a course on employee benefits and ERISA, and students hoping to work in the labor and employment area frequently find that ERISA work is plentiful, and traditional NLRA work is not. This, of course, reflects larger changes in the market for legal services. This past term, the U.S. Supreme Court did not decide a single NLRA case. There is anecdotal evidence which suggests that unions avoid federal litigation whenever possible, because the courts are perceived to be hostile to their interests. Whatever the explanation, the action in the labor and employment arena has clearly moved from traditional labor law to employment law and employee benefits.

The attention that law schools now give to employee benefits is also increasingly being reflected in the popular media. I imagine that many readers remember December 2001, when it seemed impossible to read a newspaper without encountering a story about the Enron scandal. Most of the stories made mention of the consequences for Enron employees of pension plans that were heavily invested in now-worthless Enron stock. For a while there were calls to amend ERISA to prohibit these kinds of investment options, but those calls have largely died down and the public has turned its concerns toward other things.

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Enron, of course, was not the only corporate scandal to break early in the new century. Global Crossing and WorldCom became household names, in large part because of the exceptional acts of corporate greed they exposed, but also because of the impact of the scandals on employee benefits.\(^2\) The focus on the benefits dimension of these crises generated, I think, considerable anxiety both inside and outside the academy about the reliability of our present system of benefits regulation. This Article will discuss that system, and, in particular, the external events which have made improving the present weak regulatory regime difficult. I will argue that the dramatic decline in union density, combined with the health insurance crisis and problems with ERISA that have resisted solution, are at the core of the vague sense of panic many employees feel about the future of their benefits.

I. THE CURRENT STATE OF EMPLOYEE BENEFITS

A. The Decline in Union Density

Union density in the private sector has been declining for the last fifty years.\(^3\) The general decline in union density has been accompanied by a shift of union power from the private sector into the public

2. See Greg Gatlin, Suit Says Polaroid Cut off Aid for the Disabled, BOSTON HERALD, July 9, 2003, at 33; Richard Mullins, Lawyers OK Deal in Global Lawsuits, ROCHESTER DEMOCRAT & CHRON., June 26, 2003, at 1A (noting that Global Crossing’s 2001 bankruptcy devastated the pension accounts of thousands of people in the area who worked at Frontier, which Global Crossing acquired and later broke up for sale. “A key hurdle in the negotiations was crossed when insurance companies agreed that policies they hold protecting Global executives could be used to provide some money toward a potential settlement [with employees who lost their jobs].” The proposed settlement would make $200 million available to 13,000 current and former Global Crossing employees.).

3. Seymour Martin Lipset & Ivan Katchanovski, The Future of Private Sector Unions in the U.S., in THE FUTURE OF PRIVATE SECTOR UNIONISM IN THE UNITED STATES 10 (James T. Bennett & Bruce E. Kaufman eds., 2002). In 1953, 35.7 percent of the non-agricultural private workforce was unionized. That number has since steadily declined to a recent low of 9 percent. Id. However, there has not been an associated decline in union density in the public sector. Keith N. Hylton, Law and the Future of Organized Labor in America 2–5 (Boston Univ. Sch. of Law Working Paper No. 03-14, 2003), available at http://www.bu.edu/law/faculty/papers/pdf_files/HyltonK073003.pdf. Additionally, the rate of decline varies with geography: union membership rates are higher than the national average in traditional strongholds like Michigan, Minnesota, and Wisconsin, but the percentages are much lower in states such as North and South Dakota. See Douglas Clement, Labor Pains, FEDGAZETTE, http://minneapolislefed.org/pubs/fedgaz/01-05/labor.cfm (May 2001). Michigan’s level of union density as of the year 2000 is 20.8 percent; Wisconsin’s union density is 17.6 percent; Montana’s union density is 13.9 percent; North Dakota’s union density is 6.5 percent; and South Dakota’s union density is 5.5 percent. Additionally, compared to the 9 percent national decline over the last five years, union density has fallen faster in all Ninth District states but Wisconsin. Id.
This is an important facet of the current state of employee benefits because unions were once the vehicle by which employees effectively negotiated with their employers. As the power of unions declines, workers, particularly those in the private sector, are left without significant bargaining power in all matters relating to employment, including benefits.

That the decline in union density suggests a decline in bargaining power is made clear when one considers which employees have pension plans. Approximately 70 percent of union workers in private industry have defined-benefit pension plans. Yet, only 16 percent of private sector nonunion workers have similar plans. These statistics suggest at least two conclusions: (1) private sector union strength is declining, and (2) a correlation exists between union density and pension coverage.

Some have argued that the link between density and pension coverage is related to a worker's worth: if a company can find less costly workers to perform the same job functions as its current workers, the worth of the more costly batch is devalued.

A variety of explanations have emerged to account for this decline and the subsequent unease about the future of benefits. Among commentators that are sympathetic to unions, the leading theory for the marked decline in union density is employer resistance. Other

4. Hylton, supra note 3, at 6 (noting that 44 percent of unionized workers are employed in the public sector).
5. Clement, supra note 3.
6. Id.
7. See id. The Minnesota Construction Trades Organizing Association ("MCTOA") staged a rally at Minnesota's State Capitol demanding the repeal of a property tax exemption given to builders of a 540-megawatt power plant in southern Minnesota. The MCTOA claimed the plant hired out-of-state workers to build the plant and undercut prevailing union wage rates. The builders offered $9 an hour for all workers, instead of the $13 hourly wage commonly paid in that part of the state for day laborers, and the over $30 an hour for electricians and pipefitters. Clement argues that management focuses on the "bottom line," being profitability. Id. Because globalization opens U.S. markets to low-cost producers from around the world, finding cheaper labor is an "undeniable attraction." Id. These competitive forces close mines, lumber mills, and factories in the Upper Midwest and funnel labor either to largely nonunion states in the South or overseas, where unions may not exist and prevailing wages are far lower. See also Gary Olson, Class Society Grows as Labor Unions Decline, MORNING CALL (Allentown, Pa.), Sept. 2, 2002, at A9.
9. Estreicher, supra note 8, at 4 (citing Richard B. Freeman, Contraction and Expansion: The Divergence of Private Sector and Public Sector Unionism in the United States, in LABOR
proposed explanations for the decline in union density include the new global economy, the changing composition of the workforce, the growing contingent workforce, deficiencies in the NLRA structure, the nature of unionism, and individualism.10

The most troubling of these explanations are employer resistance, the global economy, and the contingent workforce. These factors are most troubling from a benefits perspective because all can be linked to a decrease in the cost of benefits to the employer.

Employers are, of course, interested in maximizing profits. Inherent in the goal of maximizing profits is the need to minimize costs. An employer that can eliminate or reduce the cost of benefits will be a step ahead of its benefits-paying competition. Unions are most successful when they have a monopoly in a market because a monopoly takes wages out of competition—all employers must pay the same amount for the same work and consumers have no choice but to pay the labor costs.11 A globalizing economy, however, allows employers to reduce the high cost of union labor by making it possible for employers to hire people in developing countries, where labor is cheap and unions are not a factor.12 This in turn puts wages back in competition. An employer that is paying for union labor and the associated benefits may find that his customers would rather buy more cheaply from an employer with reduced labor and benefits costs.

The growing contingent workforce may also bear some responsibility for the continuing decline in union density.13 The argument is that the contingent workforce is an attractive source of labor for employers that seek to reduce costs because much of the contingent workforce is not afforded the same protections and benefits as long-term employees, and further, the remaining contingent workers generally do not have a vested interest in improving working conditions.14 Because employers are not required to extend benefits to some mem-


12. Befort, supra note 8, at 362-64.

13. The contingent workforce refers to workers that are "independent contractors, contracted workers, leased employees, part-time employees, and temporary employees." Befort, supra note 8, at 367.

bers of the contingent workforce and because other members of the contingent workforce lack incentive to effect change, the contingent workforce offers a cheaper alternative to the traditional long-term employee.

As I have argued elsewhere, my view is that the contingent workforce explanation for the decline in benefits and an increase in benefits-anxiety is a weak one. "Many of the employee benefits that workers care about most deeply are entirely discretionary with employers. There is no federal or state health requirement that employers offer insurance, disability (short- or long-term coverage), private pensions, or vacations (paid or unpaid)."

B. Health Insurance

1. The Growing Uninsured Population

The forty-two to sixty million people who lack health insurance arguably are the problem with which benefits reformers are most concerned. Many of these uninsured Americans are employed. In fact, a substantial sub-group of uninsured Americans are families with two wage earners but no health insurance for themselves or their children. How does this happen?

The absence of coverage generally results either from the employer choosing not to offer health insurance as part of its compensation package or the inability of the employee to afford his or her portion of the premium. Health care costs have been on the rise for the last several years—double-digit rates of increase appear to be the norm—and there is no reason to think that this trend will end soon.

15. Legally, independent contractors, contracted workers, and leased employees are not employees of the entity that is benefiting from their services. For this reason, these employees are not entitled to benefits. Id. at 370.
16. Temporary employees and part-time employees may find that because they are only at one location for a relatively short period of time, they lack an incentive to organize and to effect change. Id. at 370-71.
19. See Judith Nemes, Employers Taking Steps to Manage Hospital Costs, BUS. INS., Feb. 3, 2003, at 21 (citing a Blue Cross and Blue Shield Association study that found hospital services costs for patients continue to rise despite hospital and health system consolidation, which should have led to lower charges. The report noted that for every one percent increase in market share from consolidation, there was a two percent jump in inpatient charges).
In fact, the Supreme Court's recent ERISA decision in *Kentucky Association of Health Plans, Inc. v. Miller* suggests that the cost of providing health insurance to employees will only continue to increase.20

2. The Supreme Court and the Cost of Health Insurance

The recent decision upholding any willing provider ("AWP") laws will undermine the already tenuous ability of Health Maintenance Organizations ("HMOs") to control prices by forcing providers to accept lower rates in exchange for guaranteed patient volume. In *Kentucky Association of Health Plans, Inc. v. Miller*21, various HMOs doing business in Kentucky sued the Commissioner of the Department of Insurance.22 The HMOs challenged Kentucky's AWP laws on the ground that ERISA pre-empted such provisions.23 The district court, the Sixth Circuit, and the Supreme Court all held that the AWP laws survive ERISA because the laws "regulate insurance" within the meaning of ERISA's savings clause.24

The statutory requirements that the plaintiffs challenged are part of Kentucky's Health Care Reform Act ("HCRA").25 In 1994, Kentucky required health insurers to recognize "any provider who is located within the geographical coverage area of the health benefit plan and is willing to meet the terms and conditions for participation established by the health benefit plan."26 In 1996, Kentucky enacted a similar provision for chiropractors.27 The plaintiffs alleged that these provisions are pre-empted by ERISA because they relate to an employee benefit plan within the meaning of section 11441(a) of ERISA, and that ERISA section 1144(b)(2)(A), which saves laws that regu-

21. Id.
22. Id. at 1474.
23. Id.
25. KY. REV. STAT. ANN. § 304.17A-100(4)(a) (repealed 1999) [hereinafter KHCRA].
26. Id. at § 304.17A-110(3) (repealed 1999) (current version at § 304.17A-270 (Banks-Baldwin 2001)).
27. Id. at § 304.17A-121(2) (Banks-Baldwin 2001).
late insurance, does not save the state law provisions because they do not regulate insurance.\textsuperscript{28}

The plaintiffs challenged the provisions because the provisions threatened their core method of doing business. HMOs control costs and quality by establishing provider networks for their customers.\textsuperscript{29} A doctor who joins a provider network agrees to charge lower fees for services; the quid pro quo is that the doctors access a large patient group unavailable to non-participating physicians.\textsuperscript{30} The plaintiffs alleged that the AWP provisions would thwart their attempts to control cost and quality, and ultimately deny customers the economic benefits of provider networks.\textsuperscript{31}

The district court held that although the AWP laws do relate to an employee benefit plan within the meaning of ERISA, the laws are not pre-empted because they "regulate insurance."\textsuperscript{32} The Sixth Circuit heard the case on appeal and also found that the AWP provisions survive ERISA because they "regulate insurance."\textsuperscript{33} The Sixth Circuit applied two sets of reasoning to the case: a common sense interpretation of the meaning of "regulate insurance" and the McCarran-Ferguson factors.\textsuperscript{34} The Sixth Circuit found that, under each analysis, the AWP provisions "regulate insurance."\textsuperscript{35}

The Supreme Court affirmed the Sixth Circuit but held that the McCarran-Ferguson factors are not the proper approach to an ERISA pre-emption case.\textsuperscript{36} Rather, the Court held that a state law is a law that "'regulates insurance' under § 1144(b)(2)(A)," if it satisfies two requirements.\textsuperscript{37} "First, the state law must be specifically directed toward entities engaged in insurance. Second, . . . the state law must substantially affect the risk pooling arrangement between the insurer and the insured."\textsuperscript{38} The Court found that Kentucky's law satisfied each of these tests,\textsuperscript{39} and drew an analogy to state statutes that require

\begin{thebibliography}{99}
\bibitem{28} Ky. Health Plans, 123 S. Ct. at 1474.
\bibitem{29} Id.
\bibitem{31} Ky. Health Plans, 123 S. Ct. at 1474.
\bibitem{32} Nichols, 14 F. Supp. 2d at 1003–04.
\bibitem{33} Ky. Assoc. of Health Plans, Inc. v. Nichols, 227 F.3d 352, 372 (6th Cir. 2000).
\bibitem{34} Id. at 364.
\bibitem{35} Id. at 372.
\bibitem{36} Ky. Health Plans, 123 S. Ct. at 1479 ("Today we make a clean break from the McCarran-Ferguson factors.")
\bibitem{37} Id.
\bibitem{38} Id. (citation omitted).
\bibitem{39} Id.
\end{thebibliography}
attorneys to attend CLE classes each year. The Court noted that such a requirement regulates the practice of law because it imposes a condition, "which substantially affect[s] the product delivered by lawyers to their clients." 40

It is easy to see how this decision opens the door to increased health insurance premiums. HMOs can place effective cost controls on the practice of medicine by requiring that doctors charge lower rates. Doctors agree to this arrangement with HMOs because they know that being a member of a provider network results in a higher patient volume. If the HMOs must recognize AWP laws, the HMOs can no longer guarantee a higher patient volume and, therefore, doctors will be less inclined to agree to the cost control measures of the HMOs.

C. Benefits-Related Scandals

Each corporate scandal produces short-lived calls to reform ERISA. 41 ERISA encompasses most private employer pension plans, 42 which fall into two categories: defined-benefit plans and defined-contribution plans. A defined-benefit plan provides an employee with a specific benefit expressed as an amount payable to the employee when the employee retires. The benefit to be paid is frequently based on the employee’s years of service and a percentage of compensation paid. Also, the benefit may account for the employee’s expected Social Security income. A defined-contribution plan provides for an individual account in which the actual benefit provided

40. Id. at 1477.
41. See 120 CONG. REC. 29932 (1974), reprinted in 1974 U.S.C.C.A.N. 5177, 5186 (statement of Sen. Williams, introducing the Conference Report to ERISA); see also Bradley P. Rothman, Note, 401(k) Plans in the Wake of the Enron Debacle, 54 FLA. L. REV. 921 (2002). Congress enacted ERISA to protect employee retirement benefits. Id. at 924. To that end, ERISA contains fiduciary rules governing plan administration and investment. Id. ERISA also established the Pension Benefit Guaranty Corporation ("PBGC") to guard an employee's retirement assets against an insolvent employer. Id. at 928. ERISA therefore protects employees against threats to their retirement benefits including fiduciary breaches, poor investments, and employer insolvency.
THE CHANGING WORLD OF EMPLOYEE BENEFITS

represents amounts contributed by the employee or employer, plus investment earnings gained thereon.\textsuperscript{43}

Congress created ERISA to protect the interests of pension plan participants and their beneficiaries. The idea was to improve pension plans through the regulation of the design and operation of benefits plans,\textsuperscript{44} and to create the means to enforce the regulations and to establish pension insurance to protect against defined-benefit plan failure.\textsuperscript{45} Congress’s motivation was also based in part on concerns arising out of the full reporting and disclosure provisions of the Welfare and Pension Plans Disclosure Act of 1958 ("WPPDA").\textsuperscript{46} Some legislators felt that WPPDA did not do enough to protect employee benefit plan assets from imprudent investing and misappropriation of plan funds. At the time, many believed that existing state and federal laws were not effective in preventing or correcting disclosure abuses. Consequently, Congress designed ERISA to impose stricter fiduciary obligations on those who have discretion or responsibility for managing and handling pension and welfare plan assets. Some would argue that these obligations have contributed to the current instability of benefits.

1. \textit{Varity} and Fraud

In Texas they may say, “Remember the Alamo”; in the benefits world, many of us who worry about adequate deterrents to fraud cry, “Remember \textit{Varity}!” \textit{Varity Corp. v. Howe} may stand for many things, but one is certainly the proposition that ERISA is an ineffective deterrent for plan sponsor fraud.\textsuperscript{47}

The \textit{Varity} plaintiffs used ERISA to sue their former employer to reinstate them in the benefits plan.\textsuperscript{48} The case arose out of Varity’s

\textsuperscript{44} See Keville, supra note 42, at 532–33 (noting that ERISA protects the rights of pension and welfare plan participants by providing statutory enforcement rights and access to the federal court system); \textit{see also} 29 U.S.C. § 1132(a)(1) (2000) (authorizing a participant or beneficiary to bring a civil action against an administrator who fails to provide plan information upon request in order to recover benefits due, to enforce rights, or to clarify rights to future benefits under the terms of the plan); 29 U.S.C. § 1132(a)(2) (empowering a participant, beneficiary, fiduciary, or the Secretary of Labor to bring a civil action for breach of fiduciary duty).
"Project Sunshine" business plan. After Varity realized that a number of its divisions were losing money, Varity attempted to salvage the rest of the company by restructuring the failing divisions into a new, separately incorporated subsidiary. Varity's management expected the new subsidiary, Massey Combines, to fail, but still encouraged employees to voluntarily transfer their employment and benefit plans to the new division.

To persuade the employees of the failing divisions to voluntarily transfer, Varity held a meeting in which management told the employees their benefits would be secure and would not change if they voluntarily transferred the responsibility of managing their benefits to Massey Combines. According to the courts, however, Varity knew that Massey Combines was insolvent from the day of its creation and it hid a $46 million negative net worth by overvaluing its assets and underestimating its liabilities. Varity was successful in persuading approximately 1,500 employees to voluntarily transfer their employment and benefits to Massey Combines. These employees made the transfer relying on Varity's assurances that they would be secure in the new company.

Massey Combines was unsuccessful from the beginning: it recorded a loss of $88 million at the end of its first year and was in receivership at the end of its second year, under which employees lost their non-pension benefits. Some of these employees, and several retirees whose benefit obligations Varity had assigned to Massey Combines, brought suit. The plaintiffs wanted to receive the benefits they would have been entitled to under their old benefits plans, had they never transferred to Massey Combines.

The District Court and the Eighth Circuit each found for the plaintiffs. The Supreme Court granted certiorari and considered whether ERISA § 502(a)(3) authorized relief for individuals or

49. Id. at 493.
50. Id.
51. Id. at 493–94.
52. Id.
53. Id. at 494.
54. Id.
55. Id.
56. Id.
57. Id.
58. Id.
59. Id. at 495.
whether it only authorized relief for the plan. The Supreme Court analyzed the language of ERISA § 502(a) and determined that the plaintiffs could proceed under (a)(3), and also determined that denying the plaintiffs a remedy would not serve an ERISA-related purpose.

ERISA, as all benefits practitioners know, does not permit the imposition of punitive or exemplary awards, no matter how egregious the conduct. The absence of punitive damages as a weapon in the arsenal against fraud necessarily means that the problem of under-deterrence lurks everywhere. Many others have commented on the need to expand the range of ERISA penalties, so I will only note that there is a well-developed body of literature on deterrence and the expected consequences of inadequate deterrence. All of the arguments, whether made in the context of torts or criminal law, apply to the kind of behavior at stake in Varity and the subsequent recent scandals with equal force. It is not unreasonable to presume that employers and plan sponsors are rational actors who are capable of recognizing the attractiveness of fraud where the downside is only a speculative, future obligation to make the victim whole. No matter how disgusted a court may be by blatantly deceptive practices, the plan sponsor knows that the court will be powerless to mete out the most severe sanction.

I have never understood the arguments I have heard against permitting the assessment of punitive damages in ERISA cases—i.e., that plan sponsors are so well behaved that the sanction is simply unnecessary. During my recent year of work with the ABA’s Labor and

60. *Id.* The Supreme Court also considered whether Varity was acting as a fiduciary when it encouraged the employees to voluntarily transfer to Massey Combines and whether Varity breached the fiduciary duty ERISA § 404(a) imposes on plan fiduciaries. The District Court, the Eighth Circuit, and the Supreme Court each answered those questions in the affirmative. *Id.* at 494–507.

61. *Id.* at 507–15.


63. See Mosler v. S/P Enters., 888 F.2d 1138, 1143–44 (7th Cir. 1989) (Judge Easterbrook noted that if a defendant will not be caught each time, fraud is profitable if the defendant is only required to return what he gained); *RESTATEMENT (SECOND) OF TORTS* § 908 cmt.a (1977); *see also* A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 877–945 (1998); Troyen A. Brennan, *Environmental Torts*, 46 VAND. L. REV. 1, 72–73 (1993) (concluding that because administrative law does not adequately deter illegal conduct, common law liability is sometimes necessary).
Employment Law Section, this argument was made to me on more than one occasion. When I hear it I always have to suppress an urge to giggle, because the premise—i.e., that all plan sponsors are honorable and free from impulses to commit fraud—has been so battered by recent events. Even if fraud was rare, that would only suggest, I think, that we would expect to see punitive damages imposed infrequently in a properly functioning system. Infrequent fraud is not an argument against the propriety of imposing extraordinary awards when the facts so warrant.

2. Under-Diversification

Even when employees have access to benefits, various external corporate and economic factors can cause them to lose those benefits.64 One thing we should have learned from the socially responsible investing debate of the 1980s is that we should not whole-heartedly subscribe to investment strategies that have not been thoroughly analyzed.

Employee Stock Option Plans ("ESOPs") have recently come under intense scrutiny in light of recent developments at United Airlines. An ESOP is a qualified plan that invests employees' money in the employer's equities.65 An employee that participates in an ESOP may find that his investment is heavily invested in the employer's equities. Thus, the employees are doubly invested in the economic success of the company: not only is the employee at risk of losing his

64. See Summers v. State St. Bank & Trust Co., 104 F.3d 105 (7th Cir. 1997). United Airlines and several unions reached an agreement in which the employees accepted fewer fringe benefits in exchange for voting control of the company. Id. at 106. This agreement increased the likelihood that employees would retain their jobs because the company's labor costs would be substantially lower as a result of the concessions. Id. United created a special issue of preferred stock carrying a 7 percent dividend to fund the employee stock ownership plan. Id. The number of preferred shares was set at 55 percent of the total number of common shares and preferred shares. Id. Rather than giving the preferred shares to the ESOP outright, United gave the ESOP the money to buy the shares from United. Id. According to the court, the transfer effectively was a gift to the ESOP rather than a sale, since the ESOP did not pay for the stock and United did not receive anything in return for the stock. Id. The court found that the reason for the dummy sale was to obtain tax benefits when United borrowed the money to finance the ESOP's buyout of the shareholders. See 26 U.S.C. § 404(a)(9) (2000). The higher the price of the shares "sold" to the ESOP, the greater the tax advantage to United because, subject to various limitations, an employer may deduct its contributions to an ESOP or other employee benefit plan when they are made. Summers, 104 F.3d at 106. At the same time, employees defer income tax until they actually receive benefits from the plan. Id. at 106-07. Therefore, as the ERISA fiduciary for these employees, State Street Bank had to fix a price for the preferred stock that would make the ESOP's investment in that stock appear to be a reasonable investment of plan assets. Id. at 107.

job if the company does not do well, but the success of the employee’s investments will track the success of the company. The problem with this arrangement is that even the most paternalistic companies can and do fail. Ask the people who worked for Polaroid.

Edwin Land, founder of Polaroid, splashed onto the scene with the first instant photography camera in 1948. The Polaroid instant photography camera and Edwin Land’s vision built a company that few could criticize: in the 1970s Polaroid stock was listed among the Nifty-Fifty group of most sought after stocks, Polaroid was on the 1993 list of “The Best 100 Companies to Work For,” and it was one of the first companies to offer work-family, domestic violence, and education benefits to its employees. Land led Polaroid through various highs and lows throughout his tenure at the head of the company, but all that came to an end in the late 1970s when Polavision, his latest product, became the company’s biggest failure. Despite Polavision, the employees remained loyal to Polaroid and Land’s vision. Due to this loyalty, employees rallied together to save the company about ten years later when Disney launched a hostile takeover in 1988.

Polaroid responded to Disney’s attempt by forming an ESOP. To fund the ESOP, Polaroid borrowed $300 million and placed it in the ESOP. Polaroid then issued new stock, which the ESOP purchased at market price. At the same time, Polaroid deducted 8 percent of its employees’ salaries to pay for the stock and reduce the debt. The speed with which Polaroid was able to institute the ESOP made Disney’s takeover attempt futile. However, I think that if the employees knew then what they know now, they might have opted for the takeover.

The mandatory ESOP continued until Polaroid filed for bankruptcy in 2001. Under the program, Polaroid would automatically invest 8 percent of an employee’s salary in company stock that the

68. Syre, supra note 66.
70. Id.
71. Id.
72. Id.
73. Id.
74. Id.
employee was generally not allowed to sell while working for the company. These restrictions created problems for the employees that remained with the company until bankruptcy: they could not sell the stock when it started to decline, even though they knew that the company's economic difficulties were threatening their jobs and their retirement savings. The employees who were forced to invest 8 percent of their salary in company stock for as many as thirteen years saw their stocks delisted in October 2001. Many of these employees were laid off at the same time that the stock lost its value.

The employees who stayed with Polaroid until they lost their jobs and much of their investments are not the only ones who suffered financially when Polaroid fell on hard times. In an effort to save the company, Polaroid reduced benefits to retirees at a time when their investments, if still in Polaroid stock, were quickly losing value.

Although Polaroid's ESOP required more of an investment from its employees than many other ESOPs, the story is the same. Employees that are dependent on one company for their income and their pension stand to lose everything when the company falls on hard times. The absence of education about under-diversification is a chronic source of employee confusion and disappointment. Ten years ago, when I was very involved in the subject known then as "socially responsible investing," it seemed obvious to me that pension investment decisions which were motivated by anything other than risk/return considerations were scary indeed. I remember describing "back-yard" investment schemes that were designed to keep investors' money in a particular state or region of the country so as to pro-

75. Id.

76. Id. Daniel J. O'Neill participated in the Polaroid ESOP for all thirteen years. In 1997, Polaroid stock hit its high and his stock was worth more than $60,000. However, in October 2001, those shares, combined with O'Neill's subsequent investments in the ESOP, were worth about $600. Id.


78. Krasner, supra note 69.


80. Most companies that have ESOPs offer the ESOP as an addition to employee benefits. Polaroid, however, required employees to take part in the program. The culture that Land cultivated at Polaroid is part of the reason that Polaroid was able to institute such a mandatory program. Krasner, supra note 69.

81. For example, the employees of Dan River, Inc. agreed to forego their profit sharing, stock bonus plan, and pensions in order to participate in an ESOP in 1983. Six years later, the company agreed to a take over after laying off 59 percent of its employees. Krasner, supra note 69.
duce the twin benefits of more jobs and great investment returns. These programs failed then because of an obstinate refusal to respect the diversification principle; I am astonished that we continue to see examples of concurrent job and pension loss due to pension plans that are heavy with the plan-sponsor's stock.

II. LOOKING TO THE FUTURE

A. A Framework for Thinking About These Issues

I remember that when I first began to do ERISA work about fifteen years ago, I had to scramble for good reading and background material because I never took a law school course on employee benefits. After consulting many business school textbooks and Harvard Business School case studies, it became clear to me that, at least from the perspective of management, benefits simply are a part of the cost of hiring and retaining a worker.83

Benefits represent a portion of the sum total of energy, time, and monetary cost an employer invests in developing an employee into a profitable agent of the organization. Benefits are merely a part of total compensation. A commonly asserted management objective in creating and maintaining pension plans and other benefits is to maximize those factors that increase employee loyalty and tenure. The manager's goal is to generate sufficient productivity from an employee to cover the employee's entire compensation package, including benefits, and still produce a profit.84

My experience in teaching and thinking about benefits issues has led me to believe that focusing on benefits as just one component of total compensation is particularly helpful in that it avoids the pitfall of excess political baggage that tends to inject a great deal of emotion and confusion into conversations about benefits reforms.85 One can-


83. See generally BEAM & MCFADDEN, supra note 43, at 11–12 (explaining that a company's benefits system is usually designed around considerations of the benefits an employer feels should be in the plan, how the plan should be funded, the provisions contained in the plan for controlling costs, and how the employer intends to communicate the plan to employees).

84. Id. at 12.

85. Beam states that the "proper design" of an employee benefits plan is an evolving process, rather than a one-time decision. Discussing benefits in terms of discrimination claims focuses on the idea that the employer makes a definitive, one-time decision to treat one employee better than another for a reason other than merit. However, adhering to this perception ignores
not understand why employers have failed to offer an important benefit without looking at the labor market the employer competes in and remembering that, in the United States, almost all of the benefits that survey data suggests are important to workers are discretionary. That is, employers are free to offer a compensation package that is all cash and no benefits if they wish. (The notable exceptions on the mandatory side are Social Security and Medicare, unemployment insurance, and workers compensation.)

In order to figure out how to get more employers to offer health insurance, or childcare benefits, for example, it is necessary to first understand why they are not doing so as part of the normal give and take of the hiring and negotiation process. In other words, if the benefit in question is as valuable as its proponents suggest, why are workers unable to successfully demand it? To answer this, we have to focus on the total compensation framework and the decline in union density.

I propose thinking about benefits from a purely economic point of view because all other conversations tend, in my experience, to be unproductive given the ever-present reality in the U.S. that employers are free to avoid all discretionary benefits and simply pay cash for the labor it needs. I would like to suggest that childcare, health insurance, disability insurance, and a host of other benefits are best discussed exclusively in terms of cost, worker productivity and competition/worker retention issues. This is preferable to a conversation focused on employer conspiracy theories about hostility to women (blatant or thinly veiled), the disabled, or anyone else, in part because it allows for a discussion that holds out the hope of producing workable proposals for improvement. Even if an employer refuses to offer, for example, short term disability benefits (which are overwhelmingly the provenance of new mothers), I suggest that we think creatively about how to create incentives for such a benefit to be offered, rather than focusing on the possible hostility to female workers which may well account for the situation.

Although I will focus below on health insurance, pension benefits, and fiduciary duty cases, the analysis I suggest is applicable to other contexts. The suggested improvements try to do two things: first, they make benefit plans more widely available to workers who wish to participate, and second, they align employer and plan incen-

the fact that the employee-employer relationship is constantly changing due to factors that change the financial and work-output needs of both the employees and the employer. Id.
tives in a way designed to honor the legitimate expectations of all parties.

B. Union Density

As I mentioned at the outset, one of the reasons I include the decline in union density in this discussion is that I believe it signals a general loss of labor's power in the marketplace. This loss makes forcing employers to offer the benefits employees desire virtually impossible. Because employees lack the power to force a solution on employers, we need a solution employers can be persuaded to accept. If union density was on the rise in the private sector, organized labor could simply negotiate a better benefits climate for itself and others. But this is not the case.

Returning to my framework, any feasible solution must consider that employers ultimately need to generate a profit. Recall the culture at Polaroid where generous benefits were the norm for many years.86

Slowing the decline in union density, if that is even feasible at this point, would almost certainly force employers to respond to employee demands for various benefits. It is interesting to note that the rise in union density in the public sector in the U.S. has brought, to those workers, some of the most generous and least costly (to the workers) benefits plans of any group of employees. I confess that I am not sanguine about this route to improving access to benefits. I see no indication whatsoever that organized labor is poised to make a comeback in the private sector, although it seems that predictions to that effect are made a couple of times every year. More wishful thinking than anything else, only a change in the trend known as "globalization," as well as a marked increase in desire to be union members by the American workforce, will reverse the present trend against union membership.

C. What to do About Health Insurance

One of the most serious problems facing the benefits community is the growing population that lacks health insurance.87 Of course, any

86. See Krasner, supra note 69 ("Because of the culture Land [Polaroid's founder] had created, employees remained fiercely loyal eight years after he stepped down and were willing to make sacrifices." [referring to the willingness of employees to take a salary cut to fund an ESOP to thwart Disney's hostile takeover bid]).

87. See Bruce Japsen, 43.6 Million in US are Uninsured: Numbers Grow for 2nd Year, CHI. TRIB., Sept. 30, 2003, at C1 (stating that 14.6 percent of the American population did not have
realistic proposal to increase health insurance coverage must be politically feasible and must ultimately make health insurance affordable to employers and employees. I will briefly describe two possible approaches. These are small employer purchasing groups and cash-for-benefits.

1. Small Employer Purchasing Groups

Small employer purchasing groups are an increasingly popular method for controlling health care costs so that employers and employees can afford to buy coverage. However, for all their successes, there are critics and stories of failure.

Small employer purchasing groups, in the form of association health plans ("AHPs"), have been the subject of much debate, both in Washington D.C. and in the popular media. On March 6, 2003, Senator Snow (R-ME) introduced a bipartisan bill, the Small Business Health Fairness Act of 2003, to amend ERISA to give small medical insurance at any point during 2001, and 15.2 percent of the population, about 43.6 million people, did not have health insurance in 2002).


There are already many organizations claiming to reduce small companies' health-insurance premiums. . . . Some companies have formed their own associations, negotiating directly with health care providers, but generally they've found that administration costs devour most of the savings. . . . Another way to gain bargaining clout is to join a professional employer organization ("PEO"). PEOs provide an array of reasonably priced employer benefits and safeguards, but business owners must give up most of their autonomy. In effect, the PEO becomes the employer and "leases out" the employees. Id. According to Campbell, medical savings accounts are also a viable route to gaining affordable health coverage. However, "the response has been lukewarm." Id.

89. Two other prominent proposals for health care reform are a universal health care system and rate regulation. Former Democratic presidential candidate Richard Gephardt (D-MO) promoted a universal health care system. See Kristen Sawada, Insurers, Lawmakers Clash over Health Care, PACIFIC BUSINESS NEWS, Jan. 14, 2002, available at http://www.pacific.bizjournals.com/pacific/stories/2002/01/14/story3.html ("Rate regulation would allow a second source to review the price calculations of health plans, ensure that money collected is directly applied to providing medical care and to have a legal floor against inadequate rates.").

90. The focus is on small employers because although 99 percent of companies that employ more than 200 people offer health benefits, only 61 percent of companies with fewer than 200 employees do so. KAISER FAMILY FOUNDATION & HEALTH RESEARCH AND EDUCATIONAL TRUST, EMPLOYER HEALTH BENEFITS 2002 ANNUAL SURVEY 3, 4, 9, 32 (2002), available at http://www.kaisernetwork.org/health_cast/uploaded_files/ACF4D95.pdf.

91. AHPs are group health plans sponsored by trade, industry, or professional associations, or by chambers of commerce. The plans must meet ERISA certification requirements, since ERISA preempts state law regulation of qualified AHPs. Small Business Health Fairness Act of 2003, H.R. 660 § 801–02, 108th Cong. (2003).
businesses better access to health care insurance. On June 19, 2003, the House of Representatives approved a measure that would allow national associations to make insurance plans available to their members. However, because the House of Representatives passed similar measures three times in the past and each time the Senate chose not to take up the bill, it is difficult to predict whether the measure will pass the Senate. Despite the Senate’s previous inaction on such bills, the political climate presently appears to be amenable to Snowe’s bill: President George W. Bush signaled his support for the measures in a recent letter to the House of Representatives:

I support legislation that would make it easier for small businesses to offer health coverage options to their employees. Through Association Health Plans, small businesses could pool together to offer group plans to all of their employees, like those available to large businesses. In addition, we are working to streamline small business regulations and paperwork. To this end, I issued an Executive Order that requires all Federal regulatory agencies to minimize these burdens on our Nation’s small businesses.

The success of small purchasing groups is grounded in their ability to consolidate employer bargaining power in a manner similar to unions. Under these purchasing alliances, small business employers band together to act as a larger employer for purposes of buying health insurance for employees. From the point of view of an insurance company, the law of large numbers makes a larger group of workers a lower-risk entity than a smaller group. The more people covered by one plan, the lower the risk for an insurance company that medical costs the employees incur will be out of line with industry averages. Hence, insurance companies are more willing to negotiate

94. Association Health Plans: House OKs 4th Version of Insurance Bill, CHI. TRIB., Jun. 20, 2003, at 2 (Bus.) (for the fourth time, the House passed a resolution allowing for association health plans, but the Senate is yet to take up the bill).
95. 149 CONG. REC. H. 8245 (daily ed. Sept. 16, 2003) (White House proclamation). Republican control of both Houses of Congress and the White House suggests that the provisions have a chance of succeeding because conservatives, as compared to liberals, are more likely to endorse purchasing pools. Dana Milbank, Bush Outlines Health Plan, Raises Funds, WASH. POST, Feb. 12, 2002, at A2.
97. “[O]nly 5% of the population consistently accounts for over half of total health care costs.” Id.
favorable rates for larger groups because they can better predict their risk exposure.

Supporters of AHPs advocate for change based in part on two large problems: first, the exceedingly high cost of health insurance sometimes forces employers to turn away the best job candidates, and second, the market for reasonably priced health insurance has created a situation in which agents are selling fraudulent policies.

All of us know that it is generally illegal to refuse to employ a person based merely on age or physical incapacities. However, some small employers report they feel compelled to consider the effect a particular job applicant will have on the company's health insurance premiums. Hiring a person who is over age fifty-five or a person that has an obvious health problem will result in higher premiums. Some small business owners realize that they simply cannot afford to hire such candidates because they will no longer be able to provide their employees with health benefits.

Some have surveyed the landscape and determined that they can successfully prey on people's desire for affordable health coverage. These opportunists offer unlicensed plans through agents that appear to be reputable. These unlicensed plans claim to be regulated by ERISA and exempt from state law. The reality is that only plan sponsors can offer ERISA plans. The agents convince the employers that this is a legitimate way to buy insurance with other employers. The agents do not tell potential customers that such arrangements must be licensed by the state and can only offer licensed insurance policies. Falling victim to a health insurance scam may place a small employer in an even worse position than not offering insurance in the first place because the employer is potentially


99. Julie Appleby, More Patients Get Stuck with the Bills: Unlicensed Insurers Prey on People Desperate for Lower Rates, USA TODAY, May 1, 2002, at 3B. One particular victim bought scam insurance from an agent that he knew; this man found himself with $50,000 of debt that the plan would not pay. Id.

100. Id.

101. Id.

102. Id.

103. Id.
liable if the plan fails.\textsuperscript{104} Although the state and federal governments are taking action against these frauds, more needs to be done.\textsuperscript{105}

Despite the need for change and all the potential benefits of small employer purchasing groups in the form of AHPs, there are numerous obstacles which have prevented the system from becoming widespread. Probably the most ominous obstacle is federal law: Title I of ERISA does not allow pools of unrelated employers or workers' associations to offer self-funded insurance plans.\textsuperscript{106} A congressional amendment to Title I of ERISA would allow these pools to operate regardless of state regulations because ERISA preempts state laws that ``regulate insurance.'' The Small Business Health Fairness Act of 2003 aims to do just this.\textsuperscript{107}

However, allowing insurance groups to operate outside of state regulations concerns some commentators. State health insurance regulations require certain insurers to offer particular coverage, known as mandates.\textsuperscript{108} Without these, many people may not realize that what they once thought were standard coverage provisions are no longer included in their policies.\textsuperscript{109} It is easy to foresee a number of employers offering only minimal coverage if the Small Business Health Fairness Act of 2003 becomes law.\textsuperscript{110}

Additionally, proponents of the Small Business Health Fairness Act of 2003 must overcome criticism and stories of past failures. One biting criticism is that small purchasing alliances do not result in pre-

\textsuperscript{104} Id.

\textsuperscript{105} The Texas Insurance Commissioner, the government of Florida, and the Department of Labor have all taken steps to prevent agents and companies from perpetuating these frauds. Id.


\textsuperscript{107} S. 545, 108th Congress (2003).


Many mandates deal with preventive measures like screening for breast, colon or prostate cancer; regular doctor visits and immunizations for children; and supplies and education for diabetics. They may also address treatment for alcohol and substance-abuse, or reproductive-health concerns like infertility treatments, contraception and maternity coverage. Some mandates say who must be covered: for example, they may forbid an insurer from dropping dependent disabled children from their parents' policies after they reach adulthood.

\textsuperscript{109} Id. (noting that mandates give consumers confidence in the coverage a plan offers; they establish a standard).

\textsuperscript{110} While the Texas governor was considering an AHP bill, Mr. Jones, a small business owner, was already determining which health insurance provisions he would eliminate. His top picks were coverage for H.I.V., AIDS, mental illness, contraceptives, and infertility. Id.
miums that are competitive with the premiums charged by insurance companies in the open market. The critics point to various studies that show that allowing insurance plans to operate outside of state mandates does not necessarily result in lower prices because these mandates are not the driving force behind the price of insurance.111

Critics are also happy to claim that these plans are not the answer because some plans have failed. One such story comes out of the West Bend Area Chamber of Commerce.112 The West Bend Area Chamber of Commerce established a coalition through which small business owners could purchase health insurance together.113 The fatal problem arose when the health insurance companies determined which businesses were a better health insurance risk and then lured the healthier companies out of the pool with more competitive rates.114

I do not mean to suggest that a few failures condemn all small employer purchasing efforts. However, it is important to note that not all experience has been positive with these plans.115

2. Cash-for-Benefits

As an alternative to association health plans, I would like to propose a more controversial system of “cash-for-benefits.” This is a system in which employees could trade their earned wages, usually

111. In 2000, Milliman USA found that state insurance mandates are responsible for less than 6.5 percent of the health insurance premiums in Texas. In the same year, the Congressional Budget Office made a similar determination. It found that exempting insurance plans from state mandates would result in a premium decrease of less than 5 percent. According to Jonathan Gruber, a Massachusetts Institute of Technology economist, a 5 percent reduction in premiums will only result in 3 percent more small employers offering health insurance. Id.


113. Id.

114. Id. A similar result occurred after the Milwaukee Association of Commerce established a similar plan. Colorado’s Cooperative for Health Insurance Purchasing (“CHIP”) also failed. However, CHIP failed because the insurance companies pulled out of the pool. The insurance companies chose not to continue doing business in this manner because it was no longer profitable for them. Marsha Austin, Small Firms Lose Low-Cost Health Care Option, Anthem Leaves Co-op; 17,000 Forced to Switch, DENVER POST, May 21, 2002, at C-1.

115. See Employee Health Care Access Act, FLA. STAT. ANN. ch. 627.6699(6) (West Supp. 2003). Small employer carriers must use a modified community rating methodology in which the premium for each small employer is determined solely on the basis of the eligible employee’s and eligible dependent’s gender, age, family composition, tobacco use, or geographic area. Rating factors related to age, gender, family composition, tobacco use, or geographic location may be developed by each carrier to reflect the carrier’s experience. The factors used by carriers are subject to office review and approval.
overtime wages, in return for benefits. This approach may be particularly attractive to two wage-earner families: one person works for money, the other works for benefits.

As part of a cash-for-benefits system, employees and employers could enter into waiver agreements to modify the current minimum wage and overtime arrangements. I imagine the system would work as follows: an employee is willing to work fifteen hours of overtime each week at less than time and half to "buy" access to group health insurance for his family. Alternatively, a worker could contract for less than the minimum wage in return for the employer financing the employee’s health plan. I imagine these arrangements would be most attractive to two wage-earner families.

I recognize that there may be real problems associated with a cash-for-benefits arrangement, and I’ll note a few here. First, the system may complicate Social Security and unemployment insurance benefits calculations. Changing the payments an employee makes to such programs might undesirably alter the levels of received benefits. Second, a cash-for-benefits system could also reduce an employee’s pension. Accepting a reduced salary may result in an employee receiving a smaller pension upon retirement. Third, changes in salary also affect tax liabilities. The design of a cash-for-benefits system would have to account for tax credits: is it possible that receiving less pay would negatively impact a taxpayer’s eligibility for working tax credits or child tax credits?

Fourth, the proposal may also cause some concern because of the potential for workers to be paid less than the statutory minimum wage, a wage that many people believe to the socially acceptable minimum payment. Is it unconscionable to allow a person to work for less than the socially acceptable minimum wage? People who enter into a cash-for-benefits arrangement would not actually be working

116. See Summers v. State St. Bank & Trust Co., 104 F.3d 105 (7th Cir. 1997). United Airlines came to an agreement with various employees’ unions whereby the employees’ retirement plan would gain voting control of the company and majority equity ownership in exchange for accepting substantially lower wages and fringe benefits for a substantial period of time.


118. See David Shactman & Stuart H. Altman, Council on the Economic Impact of Health System Change, A Study of the Decline in Employment-Based Health Insurance at 3 (May 1, 1995). Those making the smallest salary also are the least likely to be insured (of those making less than $5.00 per hour, only 14 percent are insured; only 38 percent of those making $5.00–$7.49, 62 percent of those making $7.50–$9.99, 72 percent of those making $10.00–$14.99, and 83 percent of those making $15.00 or more per hour are insured).

119. Id.
for less than minimum wage. The difference between what the employee receives in a paycheck and the minimum wage would be spent on health insurance. Essentially, it is as if the employee used his paycheck to buy health insurance. However, under my proposal the employer would make premium payments.

Fifth, there are concerns that the cash-for-benefits system would negatively impact the employee's ability to enter into major financial transactions, such as securing a mortgage. Some mortgagees determine the amount of money to offer a particular mortgage applicant based in part on the applicant's gross salary. The irony is that although a party to a cash-for-benefits system will have a lower gross income than he did prior to entering the program, he may have more disposable income because his employer secured health insurance for him at a lower rate than he could obtain on his own.

The most obvious solution to many of these concerns is making a cash-for-benefits system available to employees on a voluntary basis. In keeping with basic notions about freedom of contract, the employer and the employee would generally be free to agree to contract terms they find mutually satisfactory.

D. What to do About Pensions

1. Varsity and Sub-Optimal Deterrence

Varity was in many respects a garden-variety fraud case. This kind of fraud, I have suggested, stems in part from the absence of traditional punitive damages for plaintiffs in ERISA cases. Section 502 of ERISA provides that retirement plan participants may bring a civil action against the fiduciary of an employee benefit plan to obtain "appropriate" equitable relief. Courts generally have interpreted "appropriate" equitable relief in a manner that precludes punitive

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120. Lynn Brenner, Family Finance: Purchasing a Home will Reduce Tax Bill, NEWSDAY (New York), Sept. 3, 2000, at F3 ("Mortgage lenders don't want your monthly housing cost—mortgage payment, property taxes, and homeowners insurance—to exceed 35 percent of your monthly gross income.").


122. 29 U.S.C. § 1132(3).
awards except under exceptional circumstances. An employee that establishes that the employer or plan administrator breached the ERISA-imposed fiduciary duty must still prove that equitable relief is the only sufficient manner of providing relief.

The Restatement (Second) of Torts states, "[p]unitive damages are damages . . . awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future." Although I am not aware of empirical studies that prove punitive damages deter specific conduct, the legal community generally accepts that punitive damages can be an effective deterrent.

Economic analysis of judgments and human behavior also support the idea that punitive damages are an effective deterrent. Polinsky and Shavell convincingly argue that punitive damages are necessary in the specific instances of wrongdoers that might escape liability for their culpable conduct. Their argument is that punitive damages will not deter a potential defendant that is sure to be caught. However, punitive damages should be awarded when there is a chance that a wrongdoer will not be caught—this is the scenario in which punitive damages will be most effective and economic. The legal system must impose a deterrent in such situations because an economically rational actor will consider his chances for profit in light of the chances that the legal system will hold him liable for his actions. Punitive damages alter the scenario by accounting for this

123. See Varity v. Howe, 516 U.S. 498, 515 (1996) (equitable relief is only available to a plaintiff when Congress did not provide other adequate remedies); see also Rothman, supra note 41, at 938 (citing Harsch v. Eisenberg, 956 F.2d 651, 656–61 (7th Cir. 1992) (finding that former employees were entitled to equitable relief when a fiduciary repeatedly responded to requests for distributions from employees’ profit sharing plans with excessive hostility and resistance)).


125. See Polinsky & Shavell, supra note 63; Haddock, McChesney, & Spiegel, supra note 121.

126. Polinsky & Shavell, supra note 63.

127. Id. at 878–87.

128. Id. at 887–900.

129. A party that knows he has a one in four chance of being held liable for a $100,000 injury has no incentive to reduce the chance of injury if the tool for reducing the probability of injury is greater than $25,000. However, if the party knows that when he is found liable he will be required to pay the cost of the damage, the cost of the control measure, and an additional sum, he has incentive to impose the control measure beforehand. This scenario may result in overdeterrence, but we can eliminate that concern by making the total damage award equal to the damage caused multiplied by the inverse of the probability that the party will be held liable for his action. Id. at 887–96.
calculus—the more likely it is that a particular wrongdoer will escape liability, the more punitive damages he must pay when held liable.\textsuperscript{130}

I believe that plan administrators are economically rational actors and that we, therefore, cannot expect optimal behavior from these parties without an optimal level of offsetting sanctions and enforcement. Plan administrators know that there is a chance they will not be held accountable for their actions. My impression is that in the absence of sufficiently strong sanctions, they may seize upon the opportunity for inappropriate profit. Even if you think \textit{Varity}-like behavior is rare, it is hard to see why punitive damages should not be available on those few occasions when plaintiffs need them.\textsuperscript{131}

2. Under-Diversification

The debate many of us engaged in about socially responsible investing during the 1980s should have taught everyone two lessons: first, we must be careful about wholesale change that is not carefully thought through, and second, we must remember that most actors are economically rational—\textit{i.e.}, regulators cannot simply force employers to “behave,” at least not without consequences.

Adequate diversification, like gravity and other laws of nature, simply cannot be ignored. Plans which are heavy with employer stock only expose participants to the double disaster of the Polaroid variety when both jobs and retirement savings are wiped out at the same time.

The many recent mini-collapses of the stock market are compelling evidence for exercising considerably more care when investing for the future. The next logical question we must answer is: What constitutes handling employee stocks, pensions, and retirement plans “more securely”? The mainstream economic argument for more secure retirement assets runs in favor of more diverse investment portfolios. I argue that in addition to deterring management from mishandling employees’ benefits and pension assets, we must prescribe a better and more diverse method of investing these assets. One of the keys to making these investments more secure is to unravel the under-diversification that plagues many employees’ pension portfolios.

\textsuperscript{130} \textit{Id.} at 887–900.

\textsuperscript{131} Current litigation concerning recent corporate infrastructure collapses of the Enron and WorldCom variety highlight the need to make punitive remedies available when employees bring \textit{ERISA}-based actions against employers acting as plan administrators.
The clear solution is a retreat from ESOP-like arrangements and all retirement vehicles which contain more than 5 percent of employer equities. Although in some situations this will make pensions more expensive for employers to offer, this is outweighed by the wisdom of not tying future pension income to an employees' current income and job security, with its resulting risk of unemployment and poverty of the elderly.

The extent to which a 401(k) plan is invested in employer stock can heavily impact the success of such a plan.\textsuperscript{132} While investment advisors generally counsel that an investment portfolio should contain no more than five to fifteen percent of any single stock,\textsuperscript{133} employees in defined contribution plans invest on average thirty-three percent of their plan assets in employer stock when it is offered as an investment alternative.\textsuperscript{134} Over-investing in a single asset of a 401(k) portfolio may jeopardize an employee's ability to retire; in addition to lacking insulation against the loss in value of a portfolio's investment, an employer's misfortunes could also cause the loss of the employee's job.\textsuperscript{135}

An employee may control the diversity of his portfolio, but the success of the investments and the portfolio as a whole depends on factors beyond the employee's control, factors such as the stock mar-


\textsuperscript{133} See, e.g., John Gin, \textit{Spread Eggs Among Baskets: Don't Own Too Much of Your Company}, \textit{TIMES-PICAYUNE} (New Orleans, La.), Apr. 3, 2001, at (Mon.)-1 (citing an August 1997 issue of \textit{Money} magazine that recommends an investor limit investments in one stock to 10–20 percent).

\textsuperscript{134} \textit{Id.} (citing to the Profit Sharing/401(k) Council of America, which found that on average, about 41 percent of an employee's 401(k) and profit sharing were invested in employers' stock); see also Facts from Employee Benefit Research Institute, \textit{401(k) Plan Account Balances, Asset Allocation, and Loan Activity in 2001}, at http://www.ebri.org/facts/0603fact.pdf (June 2003) (stating that according to the 2001 EBRI database, 401(k) participants had 16.8 percent of their 401(k) plans invested in company stock); Albert B. Crenshaw, \textit{A 401(k) Post Mortem; After Enron, an Emphasis on Company Stock Draws Scrutiny}, \textit{WASH. POST}, Dec. 16, 2001, at H1 (citing an Employee Benefit Research Institute study that found "at companies where the employer match must be in company stock, company stock also makes up 33 percent of the portion of the account that is the employee's choice," and the Profit Sharing/401(k) Council of America which found that among companies that have company stock in their 401(k) plans, "48 percent of [individuals] have between 10 percent and 50 percent in company stock, and 18 percent of [individuals] have more than 50 percent in company stock"); Janet Kidd Stewart, \textit{Stocks Can Leave Few Options; Workers at Risk if They Can't Sell}, \textit{CHI. TRIB.}, Jan. 20, 2002, at C1 (citing a study that found approximately one-ninth of the plans in the study "had more than 60 percent of their plan assets invested in company stock" and reporting that more than 80 percent of the Abbott Laboratories 401(k) plan was invested in company stock).

\textsuperscript{135} See Phillips, \textit{supra} note 132.
ket and general economic conditions.\textsuperscript{136} For example, while modern portfolio theory protects an employee against the risk of market fluctuations over the course of a career, the theory only minimizes investment losses during stock market declines.\textsuperscript{137} Therefore, an employee properly using modern portfolio theory to invest 401(k) plan assets may still accumulate an insufficient amount of assets for retirement if a large part of an employee's career coincides with a period of unsatisfactory market performance.\textsuperscript{138}

CONCLUSION

I think that some, although perhaps not all, of the benefits problems we face today present themselves so acutely because of the decline in union density in the U.S. over the past half-century. There are, of course, many other problems in the American workplace that would present themselves differently were an organized workplace the norm.

The central question facing the benefits community at this time is how to make the provision of health insurance and pensions attractive to the employer community which can, and frequently does, decline to offer anything other than cash as compensation. I am of the view that unions will not be making a comeback in the private sector anytime soon. That said, what can be done with respect to increasing the numbers of employees with health insurance? I offer two proposals. First, we ought to look much more closely at the small employer purchasing group experiments that are going on and focus on those that are most successful. Second, I suggest we permit willing employers and employees to bargain for compensation arrangements that are now impermissible because of minimum wage and overtime laws. Employees who wanted to could "purchase" health insurance with a specified number of hours of uncompensated overtime or with a lower hourly wage. I suspect that these arrangements would be attrac-


\textsuperscript{137} See Harry M. Markowitz, Portfolio Selection, 7 J. FIN. 77, 79 (1952) ("Diversification cannot eliminate all variance... in expected returns.").

\textsuperscript{138} See Solomon & Coe, supra note 136. For example, in October 1987, when the value of stocks fell by one-third, equity-based 401(k) plans, notwithstanding modern portfolio theory, inevitably lost approximately one-third of their value. This dramatic drop in the value of 401(k) plans surely altered the ability of many employees to retire as planned. Accordingly, a 401(k) plan's success, to an extent, depends on the state of the market at the time an employee's retirement funds are distributed.
tive to dual earner households; in effect one might work for wages and the other for benefits. Finally, with respect to pension reform, the recent spate of corporate scandals suggests that both the availability of punitive damages under ERISA and new rules limiting the amount of employer stock an employee’s pension portfolio can carry would be good first steps toward improving plan sponsor behavior and increasing plan asset diversification.

The benefits world may be a scarier and more cynical place of late, given recent revelations about corporate malfeasance and the absence of strong, organized employee unions. It is not, though, a place without any prospects for positive change and improvement. Employers, for the most part, want to offer needed benefits and are willing to do so if they can afford it, especially where evidence suggests it enhances employee morale, retention, and loyalty. We cannot expect, however, that employers will act contrary to their own basic economic interests and offer benefits when the cost of doing so would mean that total compensation will outweigh the value of the employee’s marginal product. An employer that operates in that fashion will not remain in business for long, and that, in turn, is an unattractive situation for everyone.