THE U.S. CULTURE OF EMPLOYEE OWNERSHIP AND 401(K) PLANS

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In the following article, Professor Dana Muir analyzes the cultural environment surrounding employee stock ownership in the United States and how it affects 401(k) plan legislation and jurisprudence. Tracing the history of American employee stock ownership plans (ESOPs) from its roots in early twentieth century profit-sharing plans to the recent phenomena of Silicon Valley's boom and bust, Professor Muir illustrates the growth of employee equity as a staple of corporate America that, in the context of 401(k) plans, seemingly contrasts American cultural values such as individualism and a high tolerance for uncertainty. While most publicly traded companies with a 401(k) plan offer company stock as an optional investment vehicle,

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this option is neither legislatively required nor limited as to scope, and may serve employer interests in excess of those of the employee beneficiaries. Following corporate scandals in recent years concerning employee stock investment and the decline in the U.S. stock markets, numerous class action lawsuits have been brought by employees against employers and their representatives that serve as benefit plan fiduciaries. Professor Muir revisits these suits with U.S. cultural values in mind and contends that the presumption of prudence applied in ESOP litigation may not be appropriate in 401(k) cases because the overall benefit to employers of unrestricted employee stock ownership oversteps the "incidental benefit" threshold mandated by the Supreme Court. Finally, she argues that employers' actions as fiduciaries should be more heavily scrutinized with respect to American cultural norms that have proven to be at odds with heavy employee investment in employer stock.

I. Introduction

Most publicly traded companies in the United States that sponsor a 401(k) plan offer company stock as an optional investment vehicle in the plan.[1] Some companies also make matching contributions with employer stock and may impose restrictions on the ability of employees to diversify out of that stock.[2] After the corporate scandals, such as the one that occurred at Enron, and the decline in the U.S. equities markets, employees brought numerous class action lawsuits[3] against the companies sponsoring those plans, their officers, directors, and other plan fiduciaries, alleging that the use of company stock violates the Employee Retirement Income Security Act of 1974 (ERISA).[4]

In this article I consider the effect of the U.S. culture of employee ownership on the use of company stock in 401(k) plans. Although I acknowledge the importance of the issue, I make no attempt in this article to answer the question of whether it is good public policy to permit or even to encourage the use of company stock in those plans. Instead, I am interested in the extent to which there might be a culture supporting employee ownership in the United States and, assuming there is such a culture, how that culture has affected 401(k) legislation

1. Susan J. Stabile, *Another Look at 401(k) Plan Investments in Employer Securities*, 35 J. MARSHALL L. REV. 539, 541 (2002).
2. *Id.* at 542.
3. See *infra* Part IV for a discussion of this litigation.
4. Employee Retirement Income Security Act of 1974 (ERISA) §§ 1–4402, 29 U.S.C. §§ 1001–1461 (2000).

as well as its effect on the significant number of cases now challenging the past use of employer stock in 401(k) plans.

In Part II, I briefly explain Dr. Geert Hofstede's approach to analyzing culture and where the United States ranks on the cultural dimensions he measures. I then review the development of formal programs that have worked to encourage employee ownership in the United States. Next, I analyze how views of employee ownership contributed to legislative provisions permitting, and to some extent even encouraging, the use of employer stock in 401(k) plans. In Part III, I evaluate the evidence on employee and plan sponsor decision making regarding the use of company stock in 401(k) plans. I also consider whether cultural dimensions are consistent with the use of company stock. In Part IV, I turn to an analysis of how the U.S. culture favoring employee ownership is affecting the development of legal doctrine in the recent lawsuits on company stock.

II. The Culture of Employee Ownership and Plan Legislation

A. Cultural Effects and Consideration

Any discussion of the way U.S. culture affects the use of company stock in 401(k) programs must be set in the context of what "culture" means for the purposes of the discussion. The potential approaches range from a simple dictionary definition to deeply researched and nuanced dimensions such as those described by Dr. Geert Hofstede. This article will use a middle-ground approach—tying in relevant scholarship where possible, but remaining willing to think in the broad terms of culture as "the body of customary beliefs, social forms, and material traits constituting a distinct complex of tradition of a racial, religious, or social group."[5]

At the 2004 conference of the European Network for Research on Supplemental Pensions, Professor Paul Roels suggested that the dimensions of culture developed by Dr. Hofstede and others might help to explain differences among national pension systems.[6] For example,

5. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 552 (Philip Babcock Gove ed., 1993).

6. *See* Paul Roels, Bringing the Cultural and Historical Backgrounds of Pension Systems Into Account, Address at the Conference of the European Network for Research on Supplemental Pensions (Sept. 17, 2004) (PowerPoint presentation notes on file with author).

Professor Roels suggested that the United States's high score levels of individualism helped to explain its 401(k) plans, which provide individual employees with significant individual decision-making power.[7] In this article, I inquire whether Dr. Hofstede's work can form the basis of insights on the use of company stock in 401(k) plans.

Dr. Hofstede's work identifies five dimensions of culture: "power distance, uncertainty avoidance, individualism, masculinity, and long-term orientation."[8] Power distance measures the inequality of power in such things as prestige, wealth, and power in a society.[9] The United States ranks thirty-eighth on a list of fifty-three countries and regions, putting it in the middle-to-low range on power distance.[10] Uncertainty avoidance, which Dr. Hofstede distinguishes from risk avoidance, reflects the levels of tolerance in a society for such things as ambiguity, varied opinions, and tradition.[11] The United States ranks even lower on this dimension, at forty-third of fifty-three countries and regions, meaning that uncertainty avoidance is relatively unimportant.[12]

Dr. Hofstede also contrasts individualism with collectivism, taking into account such factors as gregariousness and the functioning of institutions.[13] The United States had the highest score, just ahead of Australia, on this dimension.[14] The gender dimension of masculinity/femininity according to Dr. Hofstede reflects "the common pattern of male assertiveness and female nurturance."[15] The United States ranked quite high, at fifteenth of fifty-three countries and regions, meaning that the overall population tends to exhibit the masculine dimension of culture.[16]

Finally, Dr. Hofstede measures societies for a long-term orientation, looking at values such as persistence and thrift, compared to a short-term orientation which would be reflected by values such as personal stability and expectation of quick results.[17] Not all countries

7. *See id.* at 9.
8. GEERT HOFSTEDE, CULTURE'S CONSEQUENCES 1 (2d ed. 2001).
9. *Id.* at 79.
10. *Id.* at 500.
11. *Id.* at 146.
12. *Id.* at 500.
13. *Id.* at 210.
14. *Id.* at 500.
15. *Id.* at 280.
16. *Id.* at 500.
17. *Id.* at 360.

were scored for this dimension, but the United States ranked twenty-seventh out of the thirty-four countries and regions that were scored, meaning that the United States ranks relatively low on the scale of long-term orientation, tending more to the short-term.[18] The implications of this in the use of company stock in 401(k) plans of the U.S. rankings on cultural dimensions is discussed in Part III.C. below.

B. History of Employee Participation and Ownership Programs

Historically, both business leaders and labor promoted employee ownership in the United States, though they focused on different forms of ownership. Formal attempts to enable employee ownership have ranged from profit-sharing plans to organization of businesses as cooperatives to sales of discounted employer stock to employee stock ownership plans (ESOPs)[19] to stock option plans. None of these plans have been without controversy and each has gone through peaks and valleys of popularity. Together, though, they illustrate the multiple ways in which employee ownership has developed in the United States. Proponents of employee ownership programs argue that the programs reflect the country's democratic ideals,[20] support "partnership capitalism,"[21] and constitute "a heroic cause."[22] Employers are also thought to favor employee ownership in order to increase productivity, encourage employees to take a long-term view of corporate success,[23] and to place stock in the hands of a population seen as generally supportive of current management and hostile to the idea of an unwanted takeover or merger.[24]

In 1794, a glass works in Pennsylvania established the first recorded profit-sharing plan in the United States. According to the company's owner, Albert Gallatin, "the democratic principle upon which this nation was founded should not be restricted to the political

18. *Id.* at 500.

19. In an ESOP, the employer stock is typically held in a trust and unavailable to an employee who remains employed at least until the employee reaches a specified age.

20. *See infra* text accompanying note 25.

21. JOSEPH BLASI ET AL., IN THE COMPANY OF OWNERS: THE TRUTH ABOUT STOCK OPTIONS (AND WHY EVERY EMPLOYEE SHOULD HAVE THEM) xiii (2003).

22. COREY ROSEN ET AL., EQUITY: WHY EMPLOYEE OWNERSHIP IS GOOD FOR BUSINESS 180 (2005).

23. *Id.* at 65.

24. Stabile, *supra* note 1, at 546–47.

processes but should be applied to the industrial operations as well."[25] Profit-sharing plans continued to be sponsored by employers[26] and received legislative attention as early as the 1930s.[27]

In the mid-1800s, trade cooperatives began to succeed in England.[28] Workers in the United States followed this cooperative paradigm, for a time, with some success.[29] In contrast, in the late 1800s and early 1900s some well-known business leaders promoted employee ownership through ownership of the stock of their employers. Consistent with the recommendations of a commission formed by John D. Rockefeller Jr., a number of large U.S. employers offered discounted stock to their employees, which resulted in significant levels of employee ownership in companies such as Procter & Gamble, AT&T, and Kodak.[30] The market crash of 1929 and the ensuing Depression dealt a blow to both profit-sharing and stock ownership plans.[31]

The next significant attempt to establish a formal mechanism to encourage employee ownership in the United States is generally attributed to Lewis Kelso.[32] Following a 1953 ruling by the Internal Revenue Service (IRS) which permitted corporations to increase leverage by borrowing money through the establishment of a trust, Kelso established the first equivalent of an ESOP at a small newspaper company in order to avoid a hostile takeover of the paper.[33] He continued to structure similar transactions, using a trust and stock bonus plan, although some lawyers argued the transactions were problematic.[34]

25. PROFIT SHARING MANUAL 16–17 (Joseph B. Meier ed., 1957).

26. From the early 1900s until the stock market crash of 1929, U.S. businesses increased their use of profit sharing and stock ownership plans. *See id.* at 18.

27. In 1938, a subcommittee of the U.S. Senate held hearings on profit-sharing, which eventually culminated in the Vandenburg Report. *See generally* SUBCOMM. OF THE COMM. ON FIN., SURVEY OF EXPERIENCES IN PROFIT SHARING AND POSSIBILITIES OF INCENTIVE TAXATION, S. REP. NO. 76-610 (1939).

28. *See* ROSEN ET AL., *supra* note 22, at 50.

29. *Id.* at 50–51.

30. *Id.* at 52. These discounted employee stock purchase programs were not without their critics. *See id.* at 53–55.

31. Dana Muir, *Groundings of Voice in Employee Rights*, 36 VAND. J. TRANSNAT'L L. 485, 490 (2003); *see also* ROSEN ET AL., *supra* note 22, at 53–55.

32. William H. Simon, *The Prospects of Pension Fund Socialism*, 14 BERKELEY J. EMP. & LAB. L. 251, 271 (1993); Ezra Field, Note, *Money for Nothing and Leverage for Free: The Politics and History of the Leveraged ESOP Tax Subsidy*, 97 COLUM. L. REV. 740, 749 (1997); Matthew M. O'Toole, Comment, *The Disproportionate Effects of an ESOP's Proportional Voting*, 85 NW. U. L. REV. 824, 833 (1991).

33. JOSEPH R. BLASI, EMPLOYEE OWNERSHIP: REVOLUTION OR RIPOFF? 18 (1988); O'Toole, *supra* note 32, at 833 n.48.

34. ROSEN ET AL., *supra* note 22, at 61.

Kelso was a practicing lawyer whose study of social and economic theory eventually led him to believe that enterprise ownership should be spread widely to reduce inequities in wealth distribution.[35] His theories of worker capitalism through share ownership were not limited to the idea of worker ownership in the enterprises where they worked, but it is that portion of his beliefs that eventually gained traction with legislators.[36] After Kelso successfully convinced Senator Russell Long of the advantages of employee ownership, Senator Long included ESOP provisions in ERISA. Kelso then formed Kelso & Co., an investment banking firm that was a leader in structuring corporate transactions to make use of ESOPs.[37]

Though the United States has a long, if somewhat sporadic, history of some advocates attempting to build a culture of employee ownership, in recent years it is the words "Silicon Valley" that may best resonate with Americans as the exemplar of wealth through employee ownership. The stories of Silicon Valley are abound with the rags to riches and empowerment of the working class tales that so appeal to Americans. The stock option culture of Silicon Valley began with a group of engineers who refused to work for a salary while the company's owners would become rich from their work. They came to be known as the "Traitorous Eight" after leaving Shockley Semiconductor Laboratory to start their own company.[38] Ironically, they left Shockley for the same reasons William Shockley had left Bell Labs to form his own company—a lack of financial incentive and professional respect.[39]

When the company that had funded their post-Shockley venture, Fairchild Camera & Instrument, later became ossified in its corporate practices and refused to extend stock options as deeply into the organization as they wished, some of the Traitorous Eight again chose to defect. Along with Andy Grove, who had also been a Fairchild employee, a few of the Eight formed Intel.[40] Another, Eugene Kleiner, also left and founded a venture capital firm that funded numerous Silicon Valley firms.[41] The Traitorous Eight have been credited with

35. *Id.* at 55–56.
36. *Id.* at 60–61.
37. Field, *supra* note 32, at 748.
38. BLASI ET AL., *supra* note 21, at 3–6.
39. *Id.*
40. *Id.* at 10.
41. *Id.* at 12.

spreading the culture of stock options through their personal success, their management styles, and their efforts at their own subsequent start-ups.[42] From the fame of the Microsoft millionaires in the 1980s to the Google millionaires of 2005, employee ownership gained through stock options in start-up tech companies made wealthy people of secretaries and programmers as well as of chief executive officers. Of course, the bursting of the tech stock bubble in 2000 instantly revoked the millionaire status of large numbers of employees who had held on to their employer's stock, but by then yet another approach, stock options for all, had been popularized as a road to employee ownership.

The focus of this article, however, is on yet another form of employee ownership—the ability of employees to invest in the stock of their employers through 401(k) plans. By the end of 2003, an estimated 42 million employees participated in 401(k) plans and plan assets totaled $1.9 trillion.[43] As discussed below, company stock constitutes a significant portion of the assets of many of those plans, especially the larger ones.[44]

C. The Legislative Enabling of Employee Ownership

Public policy in the United States has accommodated and, to some extent, supported the efforts of those who advocate employee ownership. Some legislation provided significant tax incentives to encourage the use of employee ownership, such as ESOPs.[45] Other legislation provided guidance[46] and perhaps some minimal tax advantages, such as in the case of employee stock purchase plans. Regarding 401(k) plans, Congress has repeatedly declined to cap the percentage of an employee's account that can be invested in employer stock or to ban outright the use of employer stock, as has been called for by opponents of the use of employer stock in those plans.[47]

The ESOP legislation can be clearly linked to the advocates for employee ownership. Account after account credits Louis Kelso with

42. *Id.* at 6–12.
43. Sarah Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2003*, Investment Company Institute Perspective 10 (Aug. 2004), http://www.ici.org/stats/res/per10-02.pdf.
44. *See infra* text accompanying notes 115–17.
45. Muir, *supra* note 31, at 496.
46. *Id.* at 497.
47. Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality*, 49 EMORY L.J. 1, 64 (2000); Stabile, *supra* note 1, at 557.

gaining the ear of Russell Long, a Senator from Louisiana and chairman of the finance committee, and convincing him to include a provision in ERISA that validated ESOPs.[48] While ESOP provisions have been amended numerous times since ERISA's enactment in 1974, the theoretical underpinning remains intact:

> [E]mployee ownership should and would broaden and expand ownership; encourage capital formation and innovative corporate finance; improve labor-management relations, productivity, and profitability in firms; help the economy accommodate developments in technology, the spread of transfer payments, and inflation; and create an economic democracy.[49]

Unlike the ESOP provisions as enacted in 1974, provisions allowing 401(k) plans[50] came later, in 1978.[51] Also unlike the ESOP provisions, which required ESOPs to invest their assets primarily in employer stock, there is no indication that Congress gave any thought to the use of employer stock in 401(k) plans when drawing up the 401(k) provisions.[52] Commentators have observed that Congress did not anticipate the popularity with which employers would greet the 401(k) plan option.[53] Instead, Congress' goal in enacting section 401(k) was simply to validate the practice of permitting employees to take certain profit-sharing payments either in cash or to defer receipt of the pay-

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48. Jeffrey M. Hirsch, *Labor Law Obstacles to the Collective Negotiation and Implementation of Employee Stock Ownership Plans: A Response to Henry Hansmann and Other "Survivalists,"* 67 FORDHAM L. REV. 957, 963 (1998); Stanley R. Pietruska III, *ESOPs: Corporate Advantages Put Taxpayers at a Disadvantage*, 23 W. ST. U. L. REV. 53, 61 (1995); Simon, *supra* note 32, at 271; Field, *supra* note 32, at 748; O'Toole, *supra* note 32, at 833.

49. Hunter C. Blum, Comment, *ESOPs Fables: Leveraged ESOPs and Their Effect on Managerial Slack, Employee Risk and Motivation in the Public Corporation*, 31 U. RICH. L. REV. 1539, 1542 (1997) (quoting BLASI, *supra* note 33, at 18).

50. The name of the plans comes from the section of the Internal Revenue Code that permits such plans. R. Theodore Benna, *Reflections on the Birth and Growth of IRC Section 401(k) Plans*, 22 TAX MGM'T FIN. PLAN. J. 353, 353 (1994).

51. Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?*, 23 BERKELEY J. EMP. & LAB. L. 1, 6 (2002).

52. Neither the conference report nor the general explanation of the act contain any reference to "company stock" or "employer stock." *See* H.R. REP. NO. 95-1800 (1978); STAFF OF JOINT COMM. ON TAXATION, 95TH CONG., 1ST SESS., GENERAL EXPLANATION OF THE REVENUE ACT OF 1978 (Comm. Print 1978).

53. Medill, *supra* note 47, at 7 n.26 ("It is clear that Congress did not foresee the implications of section 401(k) when this section was added to the Code."); Lorraine Schmall, *Defined Contribution Plans After Enron*, 41 BRANDEIS L.J. 891, 901 (2003) ("In other words, the 401(k) evolved from the two amendments; it was neither anticipated nor designed by Congress.").

ments for tax purposes by electing contribution to an ERISA-governed profit-sharing plan.[54]

Although it appears that Congress did not originally contemplate the use of 401(k) plans as vehicles allowing employee investment in employer stock, Congress subsequently has considered whether to regulate those investments. ERISA prohibits defined benefit plans from holding more than ten percent of their assets in employer stock.[55] Some commentators have argued that Congress should preclude the use of employer stock in 401(k) plans,[56] while others have advocated capping the percentage of an employee's account that could be invested in employer stock.[57] I have previously suggested that employers should not be permitted to offer employer stock as an investment option unless they also provide employees with independent advice.[58] Elsewhere, Professor Schipani and I have suggested that the decision to use employer stock in a 401(k) plan should be carefully scrutinized for compliance with ERISA's fiduciary standards with an emphasis on the reduction of conflicts of interest between the fiduciaries and the interests of the participants.[59]

After the Enron scandal and the decline in the U.S. equities markets, Congress considered ways to address the issue of employer stock in 401(k) plans. In late 2001, legislation was introduced that would

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54. Benna, *supra* note 50; Schmall, *supra* note 53, at 899–900.

55. Employee Retirement Income Security Act of 1974 (ERISA) § 407(a), 29 U.S.C. § 1107(a)(2) (2000).

56. *See The Evolving Pension and Investment World After 25 Years of ERISA: Hearing Before the Subcomm. on Employer-Employee Relations of the Comm. on Education and the Workforce*, 106th Cong. 49–50 (2000) [hereinafter *Langbein Testimony*] (statement of John H. Langbein, Professor, Yale Law School) (arguing that using company stock to incentivize employees should not occur in retirement plans); *see also* Symposium, *Enron and Its Aftermath*, 76 ST. JOHN'S L. REV. 671, 820 n.20 (2002) (quoting Professor Shlomo Benartzi as stating: "Since you already have all your human capital invested in the company, my rule of thumb is, don't invest any of your plan assets in the company.").

57. Susan J. Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(k) Plan Participants to Their Own Devices*, 11 CORNELL J.L. & PUB. POL'Y 361, 401 (2002) ("Finally, Congress should consider specific changes that would cabin participant choice, such as the adoption of limitations on acquiring employer securities.").

58. Dana M. Muir, *ERISA and Investment Issues*, 65 OHIO ST. L.J. 199, 244 (2004).

59. Dana M. Muir & Cindy A. Schipani, *New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal than Others?*, 8 N.Y.U. J. LEGIS. & PUB. POL'Y 279, 355–56 (2005).

have capped employer stock at twenty percent of plan assets.[60] The bill's sponsors later withdrew the legislation, recognizing that it had insufficient support.[61] Nor has legislation proposing changes intended to increase employee access to investment advice been enacted.[62] In sum, despite strong criticism of the use of employer stock in 401(k) plans and massive losses in employee accounts, Congress has not enacted limitations or restrictions on the use of employer stock in those plans.

III. The Culture of Employee Ownership and Plan Decision Making

The use of employer stock in 401(k) plans must be understood in the context of potential employer liability under ERISA for plan investment decisions and the incentives provided by the Internal Revenue Code (IRC). In recent years, behavioral economists have sought to explain what looks like irrational employee decision making in investment choices. This Part begins by examining employer decisions to use company stock in a 401(k) plan. It then considers the factors that affect the decision of employees to hold employer stock in their plan accounts.

A. Employers' Use of Company Stock in 401(k) Plans

Regulations issued in 1992 clarified that an employer can avoid liability for poor investment choices in a 401(k) plan if the plan meets specified criteria when delegating plan decision making to employees.[63] Not surprisingly, employers typically attempt to comply with the regulations and delegate the responsibility for making investment choices to employees, at least for the portion of the money going into the plan that represents the employees' elective deferrals.[64] Frequently, employers make matching contributions to employees' plan accounts in order to encourage employee participation in the plan.

60. Stabile, *supra* note 1, at 557. ERISA does contain a provision limiting employer stock in employer-directed 401(k)s and in defined benefit plans to ten percent of plan assets. 29 U.S.C. § 1107(a)(2) (2000). ESOPs must permit employees who have reached age fifty-five and have at least ten years of plan participation to diversify their plan accounts. I.R.C. § 401(a)(28) (2000).

61. Stabile, *supra* note 1, at 558.

62. *See id.*

63. Muir, *supra* note 51, at 8–9.

64. *See* Medill, *supra* note 47, at 11.

The matching contributions may be made in employer stock, and some plans contain limitations on an employees' right to diversify out of employer stock in that portion of the account that represents the employer's matching contributions.[65]

Nothing in the regulations on delegation of plan decision making requires employer stock to be among the investment options offered by the plan. Neither do the regulations prohibit the use of employer stock as an investment option or as a source of matching contributions. Instead, the regulations simply require the plan to provide at least three investment options that together offer a sufficient variety of risk and return characteristics to enable employees to choose the risk and return combination that is right for them.[66] If the plan does not comply with all of the regulatory requirements, then the employer and plan fiduciaries may bear the risk for inappropriate investment decisions.

As with employee ownership generally, there are various reasons that help to explain why companies use their own stock in 401(k) plans. One possibility is that company management wants to place significant ownership in the hands of employees who generally are expected to support management in the event of a hostile takeover attempt.[67] There is also recognition that use of employer stock may align employee interests with that of the employer[68] and provide incentives to the employees.[69] From a financial perspective, employer contributions made in company stock can preserve cash flow for other corporate needs.[70] Finally, employers receive a tax deduction for dividends paid on company stock held in an ESOP.[71] By designating the portion of the 401(k) that holds employer stock as an ESOP, the employer can receive the deduction as part of what otherwise would be a 401(k) plan holding company stock.[72] These plans are known as KSOPs and represent approximately ten percent of all plans that hold

65. *See infra* text accompanying notes 80–81.
66. Muir, *supra* note 51, at 10.
67. Stabile, *supra* note 1, at 546.
68. Randy Myers, *Are You 401(k) Liable?*, Corporate Board Member (Sept./Oct. 2005), http://www.boardmember.com/issues/archive.pl?article_id=12323.
69. *Langbein Testimony*, *supra* note 56, at 9.
70. Myers, *supra* note 68.
71. Jack L. VanDerhei, *Company Stock in 401(k) Plans: Results of a Survey of ISCEBS Members*, BENEFITS Q. 65, 67 (3d Quarter, 2002).
72. *Id.*

company stock.[73] The relatively low adoption rate of KSOPs, however, suggests that the tax advantage of the deductions is not the driving force behind the use of employer stock.[74]

The extent to which company stock is used in 401(k) plans has been the subject of much scrutiny and varied estimates in recent years. Professor VanDerhei argues persuasively that the typical estimate of eighteen to nineteen percent[75] of 401(k) account balances held in company stock is misleading.[76] In plans that have more than 5000 participants, the large plans where the company is most likely to offer company stock as an investment choice, Professor VanDerhei's data show that 25.6% of the average account balance consists of company stock.[77] The difference in the concentration rates is significant.

Researchers typically rely on survey data to determine the percentage of 401(k) plans that offer company stock as an investment option, that make matching contributions in company stock, and that restrict employees' ability to diversify the matching contribution. In one 2004 survey, 426 plan sponsors, most with employee populations of more than 1001, responded.[78] Eighty-eight percent of the employers reported providing matching contributions as part of their 401(k) plan.[79] Only fifteen percent of the employers who provided matching contributions, but did not permit employees to direct the investment of those matches, made the contribution in employer stock.[80] Surprisingly, only thirty percent of the employers reported offering employer stock as a discretionary investment.[81] Of those employers, fifteen percent limited the portion of employees' elective contributions that could have been allocated to employer stock, with the average limit being thirty-two percent of the account.[82]

73. *See id.*
74. *Id.* In the rest of this article, as I refer to 401(k) plans I am also referring to that subset of 401(k)s that are formed as KSOPs.
75. This estimate has dropped slightly in the most recent surveys. Holden & VanDerhei, *supra* note 43, at 2.
76. Jack VanDerhei, *The Role of Company Stock in 401(k) Plans*, 5 RISK MGMT. & INS. REV. 1 (2002).
77. *Id.*
78. Deloitte Consulting, *2004 Annual 401(k) Benchmarking Survey* 2 (2004), *available at* http://www.deloitte.com/dtt/article/0,1002,sid%253D26551%2526cid%253D78971,00.html.
79. *See id*. at 13.
80. *Id.* at 14–15.
81. *Id.* at 19.
82. *Id.*

For comparison purposes, a survey conducted by Professor VanDerhei with results published in 2002 showed that forty-eight percent of the responding 375 employers offered employer stock as an investment choice.[83] This was heavily weighted to plans with 5000 or more employees, seventy-three percent of whom reported a company stock investment option.[84] Forty-three percent of the employers, weighted toward large employers, reported requiring that matching contributions be invested in company stock. In addition, eighty-seven percent of those employers that required investment in company stock imposed some restrictions on employees' ability to diversify out of the employer stock.[85]

B. Employee Investment in Company Stock

Why do employees voluntarily invest their 401(k) assets in company stock even though economists and financial planners regularly advise against investing both human and financial capital in the same firm?[86] This question has intrigued behavioral economists, who study what appears to be irrational economic behavior. The available data on employee investment in company stock also provides some insight into employee decision making. This subpart addresses each of these approaches in turn.

1. BEHAVIORAL ECONOMICS AND EMPLOYEE INVESTMENT DECISION MAKING

Behavioral economists recognize that, contrary to the predictions of neoclassical economic theory, human beings do not always act in their own economic best interests.[87] Behavioral economists use psychology to explain why actual behavior diverges from wealth-maximizing behavior. They explain that humans' limited cognitive abilities require us to use fixed and imperfect approaches to problem

83. VanDerhei, *supra* note 71, at 68.
84. *Id.*
85. *See id.* at 69.
86. Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1552 n.110 (1997); Medill, *supra* note 47, at 16; Deborah M. Weiss & Marc A. Sgaraglino, *Prudent Risks for Anxious Workers*, 1996 WIS. L. REV. 1175, 1178.
87. *See* Sendhil Mullainathan & Richard H. Thaler, *Behavioral Economics* (Mass. Inst. Tech., Working Paper No. 00-27, 2000); Charles J. Whalen, *Putting a Human Face on Economics*, BUS. WK., July 31, 2000, at 76.

solving.[88] Part of the challenge, then, is to identify and explain actual problem solving approaches.

Behavioral economists argue that individuals are overly averse to short-term losses and limited gambles—an approach known as "amyopic loss aversion." This theory began with a famous economics paper by Professor Paul Samuelson. Professor Samuelson reportedly offered a colleague the following deal: "flip a coin, heads you win $200, tails you lose $100."[89] The colleague declined, but counter offered a series of 100 such bets.[90] Economists have put much effort into evaluating whether the colleague's decision was economically irrational.[91]

To test the theory of amyopic loss aversion as applied to benefit plan investment choices, Professors Richard Thaler and Shlomo Benartzi conducted a series of experiments with university employees. They performed the study with a group of staff employees and a group of faculty.[92] Individuals were asked to allocate their plan contributions between stocks and bonds.[93] Everyone received the same content but it was presented in different types of charts—either as a chart showing the distribution of annual rates of return on a thirty-year investment or a chart showing actual distributions of historic returns in one-year increments.[94] The individuals who received the charts showing one-year incremental rates invested less in equity securities than did those who viewed the charts with annual returns on a thirty-year investment.[95] While the difference was less in the faculty group than in the staff group, the results were statistically significant in both groups.[96] Professors Thaler and Benartzi believe this outcome supports the theory that investors are overly averse to short-term losses.[97] The theory has gained some support from research indicating

88. Mullainathan & Thaler, *supra* note 87.
89. Shlomo Benartzi & Richard H. Thaler, *Risk Aversion or Myopia? Choices in Repeated Gambles and Retirement Investments*, 45 MGMT SCI. 364, 364 (1999).
90. *Id*.
91. *See id.* at 367.
92. *Id.* at 374, 377.
93. *Id*.
94. *Id.* at 375.
95. *Id.* at 377, 380.
96. *Id*. at 378.
97. *Id.* at 380.

that employees overweigh recent company performance when deciding to invest in company stock.[98]

Another theory of the behavioral economists is that, when faced with a limited set of potential investments, individuals will simply divide assets equally among the choices.[99] This is known as the "1/n heuristic."[100] In a series of experiments, Professors Benartzi and Thaler discovered that as the number of equity funds offered increased, so did the percentage of assets the study participants chose to invest in equity funds.[101] For example, in one experiment, employees could allocate hypothetical pension plan investments between a stock fund and a bond fund.[102] Another group could choose between a stock fund and a "balanced fund," which invested half in stock and half in bonds.[103] A third group's choices were a bond fund and a balanced fund.[104] The experiment revealed that the allocation decisions were heavily dependent upon the available fund alternatives.[105] The group whose options were the stock and the balanced fund allocated the largest percentage of assets to stock when the stock in the balanced fund was accounted for, followed by the group with the stock and bond fund.[106] The group offered the bond and balanced fund allocated the lowest percentage of assets to stock.[107] In this and in its other reported experiments, the study supports the hypothesis that investors loosely follow a 1/n heuristic and, thus, their asset allocations depend upon the available investment alternatives.[108]

In a different vein, Professors Benartzi and Thaler also found that employees appear to devote relatively little thought to their plan investment allocations.[109] Few study participants reviewed any material other than what was automatically supplied to them, and they tended to spend less than an hour making allocation decisions.[110] This

98. William E. Even & David Macpherson, *Company Stock in Pension Funds*, NAT'L TAX J., June 1, 2004, at 299.
99. Shlomo Benartzi & Richard H. Thaler, *Naive Diversification Strategies in Defined Contribution Saving Plans*, 91 AM. ECON. REV. 79, 79 (2001).
100. *Id.*
101. *Id.* at 92.
102. *Id.* at 82.
103. *Id.*
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.*
108. *Id.* at 92.
109. *Id.*
110. *Id.*

apparent lack of interest on the part of the participants is consistent with data showing that employees rarely change their investment choices or move assets among investment alternatives.[111]

Other researchers have also offered theories to explain overinvestment by employees in company stock. One idea is expressed as "optimistic bias."[112] The belief is that employees think their employer is more likely than its competitors to be successful.[113] Such overconfidence may lead employees to overinvest in company stock.[114] A similar theory, "familiarity bias," posits that employees are more familiar with their company than with alternative investments and, as a result, overrate the company's prospects.[115] Professor Benartzi's research distinguishes excessive extrapolation, the expectation that a series of random events can predict the future, and finds that employees are likely to rely on past returns to predict their company stock's future performance.[116]

Still other commentators cite the effects of overt or implicit pressure as affecting employees' decisions to invest in company stock.[117] That pressure may come from the company, its management, or fellow employees.[118] Senator Kennedy has referred to "pressure[] by Enron executives"[119] and Professor Stabile refers to her own experience in law practice of seeing employees who "felt pressured to put a lot of their plan assets"[120] into company stock.

111. Janice K. Lawrence, *Pension Reform in the Aftermath of Enron: Congress' Failure to Deliver the Promise of Secure Retirement to 401(k) Plan Participants*, 92 KY. L.J. 1, 60 n.290 (citing data that fewer than twenty percent of active 401(k) participants made any investment trade in their accounts in 2001).

112. Stabile, *supra* note 1, at 548.

113. *Id.* at 549.

114. *Id.* at 548.

115. Gur Huberman, *Familiarity Breeds Investment*, 14 REV. FIN. STUD. 659, 663 (2001).

116. Shlomo Benartzi, *Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock*, 5 J. FIN. 1747, 1760–61 (2001). More recent research confirms this effect for initial allocation decisions but finds the opposite with reallocation behavior. Employees who reallocate after high past returns of their employer's stock reduce their holdings of the stock. James J. Choi et al., *Employees' Investment Decisions About Company Stock* 16 (Nat'l Bureau of Econ. Research, Working Paper No. 10228, 2004), *available at* http://www.nber.org/papers/w10228 (last visited Jan. 30, 2006).

117. Stabile, *supra* note 1, at 550–51.

118. *Id.* at 551–52.

119. *Id*. at 550–51.

120. *Id.* at 551–52.

2. EMPIRICAL DATA ON EMPLOYEE INVESTMENT BEHAVIOR

As with the data on employer use of company stock in 401(k) plans, empirical data on employee investment in company stock tends to be derived from surveys. As noted above, many reports observe that in plans that offer employer stock, the stock constitutes an average of eighteen to nineteen percent of account balances. However, in large plans, which cover the majority of the participant population, 25.6% of the average account balance is invested in company stock.[121] In fact, the investment rates in company stock at some employers reportedly are much higher. During 2001, for example, 57.73% of Enron's 401(k) plan assets were invested in company stock.[122] Coca-Cola's plan has been said to hold ninety percent of its assets in Coca-Cola stock.[123]

Experts predict, based on normal diversification expectations, that if an employer's matching contribution is made in company stock, then rational employees will reduce their elective investments in company stock.[124] In fact, the opposite is true. Employees direct more of their elective contributions to company stock in plans with that characteristic.[125] Professor Benartzi has speculated that this is attributable to the employees viewing the match as an endorsement by the employer that company stock is a good investment or as implicit investment advice.[126] No studies appear to have evaluated whether stock option, stock purchase, or ESOP plans have a similar effect on employee behavior in 401(k) plans, but theoretically one would expect the effect to be similar. Similarly, when a plan offers plan investors the option of investing in company stock, those investors make substantially lower allocations to all other investment choices, particularly to mutual funds that hold equities.[127]

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121. *See supra* text accompanying note 77.
122. VanDerhei, *supra* note 71, at 67.
123. Benartzi, *supra* note 116, at 1747.
124. Nellie Liang & Scott Weisbenner, *Investor Behavior and the Purchase of Company Stock in 401(k) Plans—The Importance of Plan Design* 21, 22 (Nat'l Bureau of Econ. Research, Working Paper No. 9131, 2002), *available at* http://www.nber.org/papers/w9131 (last visited Jan. 30, 2006).
125. Benartzi, *supra* note 116, at 1752; Liang & Weisbenner, *supra* note 124, at 23.
126. Benartzi, *supra* note 116, at 1752.
127. Sarah Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1999*, EMPLOYEE BENEFIT RESEARCH INST., Issue Brief No. 230, Feb. 2001, at 11.

The theories and research of the behavioral economists and the data on actual employee investment behavior provide some intriguing possibilities for understanding employee decision making. They also have been used in modifying plans in an attempt to increase employee participation and contribution rates. For example, some plans, known as automatic enrollment plans, now default new employees into the 401(k) plan rather than out of it so that employee tendencies toward inertia work in favor of participation.[128] Other plans have offered employees the opportunity to agree to contribute a portion of future wage increases to the plan, significantly increasing contribution rates by those employees who participated in the program.[129]

C. Integration of U.S. Cultural Dimensions and Company Stock Ownership

Integrating the research on employee and employer behavior vis-à-vis the use of company stock in 401(k) plans with Dr. Hofstede's insights on U.S. culture reveals certain tensions between the use of company stock and cultural norms. This section begins by exploring whether employer use of company stock in 401(k) plans would be predicted by U.S. cultural dimensions. It then examines whether the cultural dimensions are consistent with employee decisions to invest in company stock.

1. CULTURAL DIMENSIONS AND EMPLOYEE STOCK OWNERSHIP—EMPLOYER PERSPECTIVE

As explained above, large public companies with 401(k) plans frequently use company stock within the plan in two ways. First, the employer may make matching contributions in company stock. Second, the plan may permit employees to direct that their elective contributions be invested in company stock. Commentators have offered a number of rationales for why employers would use company stock in these ways.[130] One unexamined question, though, is whether employers' use of company stock in 401(k) plans is consistent with U.S. cultural dimensions.

128. Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving*, 112 J. POL. ECON. 164, 168–69 (2004), *available at* http://www.journals.uchicago.edu/JPE/journal/issues/V112nS1/112118/112118.web.pdf.
129. *Id.* at 164.
130. *See supra* text accompanying notes 67–74.

My hypothesis is that employers may use company stock in 401(k) plans in order to change employee behavior. I evaluate the hypothesis by asking whether U.S. cultural dimensions reveal employment traits that employers logically might attempt to modify through the use of company stock. Chart I summarizes this analysis. Again, the point is not to be judgmental on the efficacy or advisability of company stock in 401(k) plans, but rather to explore potential cultural insights.

Of the fifty-three countries and regions surveyed, the United States ranked first in individualism. Employers may be confronting this norm when they use employee ownership as a tool to achieve "partnership capitalism." Company stock ownership is one mechanism to align employee goals with those of the company and its shareholders and encourage employees to act more collectively and less individually.

Though the U.S. position on the power differential dimension is more moderate, this too may be an area where employers use company stock in a targeted way to change employee norms. If employees as a group hold a sufficient amount of stock to affect the outcome of a shareholder vote or tender, that ownership decreases the power inequality typically found in U.S. employee-employer relations. Ordinarily the cultural dimensions predict that employees expect moderate power inequality and would not seek ownership in order to further decrease that power differential. One can appropriately be skeptical as to whether shareholders actually are able to exercise any power in most corporate decisions in the United States. However, in one important area, hostile acquisition attempts, commentators point to the expectation that employees will support the status quo as an explanation for company's decisions to encourage employee ownership. So it is logical that in this very specific area, where it is useful for employers to increase employee power, they use company stock in 401(k) plans to achieve that result.

A third dimension of U.S. culture that appears inconsistent with employee ownership is the relatively low position of the United States on uncertainty avoidance. Dr. Hofstede distinguishes uncertainty avoidance from risk tolerance.[131] Instead, this dimension reflects a high tolerance in the United States for ambiguity and a willingness to

131. HOFSTEDE, *supra* note 8, at 148.

accept situations with relatively little structure.[132] In the workplace, this is reflected in an increased willingness to change jobs and decreased company loyalty. To the extent employers use company stock ownership in an effort to increase loyalty, that effort may be countering this norm.

The import of the last two of Dr. Hofstede's cultural dimensions, long-term orientation and masculinity, similarly provide rationales for employer use of company stock in 401(k) plans. The United States ranks low on long-term orientation. To the extent an employer wishes to refocus employees from the short term to the long term, fostering company stock ownership through 401(k) plans may be a particularly effective way to use company stock. Stock option plans have been criticized because they encourage a short-term focus on company results and stock price. But if employees view their 401(k) accounts as long-term retirement savings, then employers that encourage company stock ownership in those accounts may help foster employee efforts to work toward the company's long-term success.

The consequence of the United States's high score on the dimension of masculinity also may reflect itself in employee tendencies that employers try to counter through the use of company stock. In the workplace, this dimension is expected to exhibit itself in employees who have a high focus on ego goals, such as personal financial success, rather than social goals, such as cooperation. More and more, however, companies have focused on teamwork and cooperation, norms that are inconsistent with the masculine dimension of U.S. culture. The use of company stock in 401(k) plans may foster teamwork, collaboration, and a consensus approach to decision making in much the same way as it may lower the level of individualism in a company. Broad-based employee ownership may encourage employees to view their interests as interdependent and thereby may increase solidarity.

132. *Id*.

Chart I
Cultural Dimensions and Employee Stock Ownership—Employer Perspective

CULTURAL DIMENSION	POSITION OF U.S.	PROJECTED EFFECT	Consistency with Employer Attempt to Change Behavior
Power differential	Middle to low 38/53	Employees expect moderate power inequality	Moderately consistent. Employers may use as a mechanism to slightly decrease inequality through voting rights, etc. and mixed nature of system gives employees limited power.
Individualism	Highest 1/53	Employees expect to act individually, not collectively	Consistent. Employers may use to increase collective approach and teamwork instead of employee individualism.
Uncertainty Avoidance	Low 43/53	Employees have a high tolerance for ambiguity, including a willingness to change jobs	Consistent. Employers may use to decrease turnover and increase company loyalty.
Long-term orientation	Low 27/34	Employees expect quick results	Consistent. Employers may use to encourage employees to work for the long-term success of the organization.
Masculinity	High 15/53	Employees have a strong focus on "ego goals" such as financial reward	Consistent. Employers may use to encourage solidarity and consensus approach to decision making.

In sum, the cultural dimensions that describe U.S. society give rise to some expected employee norms that employers may attempt to counter through the use of company stock in 401(k) plans. In this way, considering cultural dimensions adds evidence to the explanations offered for employers' use of company stock in 401(k) plans. It also, however, raises a question of the social and workplace tensions that might result from attempts to modify ingrained cultural norms. In order to further examine those tensions, the next subsection considers the effect of company stock ownership on cultural dimensions from the perspective of employees.

2. CULTURAL DIMENSIONS AND EMPLOYEE STOCK OWNERSHIP—EMPLOYEE PERSPECTIVE

Data indicates that when employees have the option of investing in company stock through a 401(k) plan, many of them choose to do so, even though the investment may not appear rational from an economic perspective. In some respects, even the use of company stock by the employer to make matching contributions is subject to the willingness of company employees to accept the contributions in that form. Behavioral economists and others have offered various explanations for employees' apparent interest in holding company stock in 401(k) plans.[133] The question I examine in this subsection is whether those investments are consistent with employees' cultural expectations. The results are summarized in Chart II, below.

The U.S. position—number one of fifty-three—on individualism is the one in which the United States is the greatest outlier compared to other countries and regions. The very strong position indicates that employees would not ordinarily place high values on sharing information or seek group-level reward allocations and cooperation. They typically would prefer to work individually rather than focusing on teamwork.[134] Ownership of company stock through a 401(k) would appear inconsistent with these expectations because the shared investment results may increase cooperation and teamwork.

Of the five cultural dimensions, the only one where the U.S. position is quite moderate is in power differential. Because employees should expect moderate power inequality in the workplace, one would not predict that employees would seek ownership of company

133. *See supra* text accompanying notes 92–118.
134. HOFSTEDE, *supra* note 8, at 244.

stock in order to decrease existing power inequality. Furthermore, the mixed power extant in most 401(k) plans seems to be consistent with the country's moderate position on this dimension. Employers may determine the investment vehicle for matching contributions, but employees typically have the power to decide how to invest their own contributions.

On uncertainty avoidance, the United States scores relatively low. If uncertainty avoidance reflected risk tolerance, then this dimension would seem to be consistent with ownership of company stock. The high tolerance for risk would help explain employee willingness to invest both human and financial capital in the same firm. Contrary to the implication of the words, however, this dimension does not capture risk tolerance. Instead, it indicates an increased likelihood of job turnover and high tolerance for ambiguity. Low expectations of long-term career commitment and company loyalty would seem to be inconsistent with strong interest by employees in investing in company stock.

The import of the last two of Dr. Hofstede's cultural dimensions, long-term orientation and masculinity, for employee ownership is mixed. The United States ranks low on long-term orientation. The focus on quick results might be consistent with the "excessive optimism" theory offered by some researchers as an explanation for high levels of employee voluntary ownership of company stock. If that optimism results from the recent financial success of the company and, as a result, employees expect similar near-term success, then the employee behavior would be consistent with that predicted by the cultural dimension. The same would be true for employees who believe their efforts would have a positive effect on the results of the company in the short term. They might be expected to willingly invest in company stock. But, to the extent that employees would choose to purchase company stock as a mechanism to participate in the long-term financial success of the firm, that would not be predicted by the short-term cultural orientation.

The consequence of the United States's high score on the dimension of masculinity is similarly difficult to tease out. In the workplace, this dimension is expected to exhibit itself in employees who have a high focus on ego goals, such as financial success, rather than social goals, such as cooperation. One result could be that the individual focus on one's own success would lead employees to put their own suc-

cess before that of the firm. That would seem to be inconsistent with a motivation to invest in company stock. On the other hand, if the employees believe their personal success will increase the value of the company and investment in company stock will enhance their financial returns, then it would not be unreasonable to expect them to invest in company stock.

CHART II
Cultural Dimensions and Employee Stock Ownership—Employee Perspective

CULTURAL DIMENSION	POSITION OF U.S.	PROJECTED EFFECT	Consistency with Employer Attempt to Change Behavior
Power differential	Middle to low 38/53	Employees expect moderate power inequality	Moderately inconsistent. Employees would not seek to decrease inequality and mixed nature of system already gives employees limited power.
Individualism	Highest 1/53	Employees expect to act individually, not collectively	Inconsistent. Employees would not seek to share collective ownership.
Uncertainty avoidance	Low 43/53	Employees have a high tolerance for ambiguity, including a willingness to change jobs	Inconsistent. Employees would not purchase company stock because of loyalty or expectation of long-term association.
Long-term orientation	Low 27/34	Employees expect quick results	Unclear. Excessive optimism theories of behavioral economists would be consistent with short-term focus.

(*Continued on next page*)

Chart II—*Continued*

CULTURAL DIMENSION	**POSITION OF U.S.**	**PROJECTED EFFECT**	**Consistency with Employer Attempt to Change Behavior**
			But, if employees view share ownership as long-term participation in their company, that is inconsistent with short-term focus.
Masculinity	High 15/53	Employees have a strong focus on "ego goals" such as financial reward	Unclear. Focus on own success would seem to put self before company, being inconsistent with investment in company stock. But, if believe own success will increase value of company and focus is on own financial welfare, then company stock is a consistent investment.

From the perspective of employees, then, there seems to be some inconsistency between U.S. cultural dimensions and an expectation that employees would choose to invest in company stock. Both individualism and uncertainty avoidance, dimensions on which the United States has strong scores, predict that employees would not voluntarily invest in company stock. The predictive effect of the power differential, long-term orientation, and masculinity dimensions are less clear but are inconsistent in at least limited ways with voluntary employee investment in company stock.

Comparing the employer and employee perspectives on cultural dimensions helps to understand the tension inherent in the use of company stock in 401(k) plans. Considering the cultural dimensions shows that employers may have good business reasons to use company stock in 401(k) plans in order to change employee behavior and

norms. Thus, employers' use of company stock in 401(k) plans would be predicted by the cultural analysis. Employees, however, would seem to have much less interest in choosing to invest in employer stock. This raises the question of whether the high levels of "voluntary" employee investment in company stock results from factors not explained by the cultural dimensions, or whether it results from at least implicit pressure by employers.

IV. The Culture of Employee Ownership and the Company Stock Litigation

Many employees with significant amounts of their 401(k) assets invested in employer stock experienced severe losses during the decline in the U.S. equity markets and as a result of the collapse of companies such as Enron and WorldCom. Those losses gave rise to lawsuits against employers, officers, directors, and other plan fiduciaries. I will refer to these cases as the "company stock cases." The lawsuits, brought primarily under ERISA, typically allege one or more of the following general types of violations. First, plaintiffs allege the plan continued to offer employer stock as an investment option, to make matching contributions in employer stock, or to disallow diversification out of employer stock when the fiduciaries knew or should have known that employer stock was an imprudent investment. Second, defendants allegedly failed properly to appoint or monitor those fiduciaries with responsibility for investment-related decisions under the plan or communications regarding the plan. Third, fiduciaries allegedly made material misstatements or omissions of disclosure regarding employer stock. The courts have issued some decisions on whether these claims are sufficient to state a claim but no decisions following trial yet exist. The Enron case has settled.[135] On the other hand, one court recently voided a settlement between the parties in a case against EDS.[136]

135. Matthew L. Weiner & Brian T. Ortelere, *Employee Stock Plans*, 26 NAT'L L.J. 13 (2004).

136. *In re* Elec. Data Sys. Corp. "ERISA" Litig., No. 6:03-MD-1512, 6:03-CV-126, 2005 WL 1875545, at *6–7 (E.D. Tex. June 30, 2005).

A. Presumption of Prudence for Company Stock

When considering what role culture might have in the company stock litigation, one might ask whether the offering of a company stock investment option should be treated differently by the courts than other investment options offered by 401(k) plans. The presumption of prudence, which has been developed in some circuits for use in ESOP litigation, is a good starting point.

ESOPs pose a particular challenge for courts evaluating a participant claim that company stock was an imprudent investment that violated the plan fiduciaries' statutory obligation of prudence. A unique aspect of ESOPs is that they must be designed to invest primarily in company stock.[137] Even in this context, though, in limited circumstances courts have put the fiduciary obligation of prudence ahead of the stock requirement and held that plan fiduciaries sometimes have a duty to review the continued prudence of investments in employer stock.[138] Courts evaluate the prudence of those investments, however, according to what essentially is an abuse of discretion standard. That approach is traceable to *Moench v. Robertson*, an ESOP case from the Third Circuit Court of Appeals.[139] The *Moench* court decided that fiduciaries enjoy a presumption of prudence for investments in employer stock. Plaintiffs may rebut the presumption by showing that "'circumstances not known to the settlor and not anticipated by him [in the making of such investment] would defeat or substantially impair the accomplishment of the purposes of the trust.'"[140] In a further refinement, some jurisdictions have stated that plaintiffs must prove that "the company is on the brink of collapse or undergoing serious mismanagement" in order to rebut the *Moench* presumption.[141]

Fiduciaries in ESOP cases face a complication in their reviews of company stock because they theoretically could face liability under ERISA's prudence and due care standard for a decision to discontinue the use of employer stock in a plan. The *Moench* court acknowledged this possibility, stating: "[I]f the fiduciary, in what it regards as an exercise of caution, does not maintain the investment in the employer's

137. I.R.C. § 4975(e)(7) (2000).
138. *See* Kuper v. Iovenko, 66 F.3d 1447 (6th Cir. 1995); Moench v. Robertson, 62 F.3d 553, 571 (3d Cir. 1995).
139. 62 F.3d 553 (3d Cir. 1995).
140. *Id.* at 571 (quoting RESTATEMENT (SECOND) OF TRUSTS § 227 comment g. (1959)).
141. Wright v. Or. Metallurgical Corp., 360 F.3d 1090, 1098 (9th Cir. 2002).

securities, it may face liability for that caution, particularly if the employer's securities thrive . . . ."[142] The potential problem is that an overly conservative decision on the availability of company stock could force employees to sell their company stock at an unfavorable time or, possibly, that the decision would deny employees the opportunity to make a lucrative investment.

It is not clear that *Moench*'s presumption of prudence approach used for ESOP investments in company stock should be used in the 401(k) company stock cases. Unlike ESOPs, ERISA does not require 401(k) plans to use company stock in any way in the plan, let alone require 401(k) plans to invest primarily in employer stock. Multiple courts, however, have applied the *Moench* presumption when analyzing a 401(k) plan fiduciary's prudence.[143]

The cultural dimensions analysis above and research findings of the behavioral economists arguably strengthen the arguments against the application of the *Moench* presumptions in 401(k) cases. The behavioral economics research indicates that, whether it is due to amyopic loss aversion, the 1/n heuristic, optimistic bias, or excessive extrapolation, the mere presence of company stock as an investment choice affects employee decision making. And, the use of company stock in matching employee contributions encourages, at least implicitly, additional investment in company stock by employees. The cultural dimensions analysis indicates employers may use company stock in the plans to change employer behavior in the workplace. These explanations for employer and employee behavior may be sufficient to negate the use of the *Moench* presumption in 401(k) plans where the use of company stock is entirely discretionary from a statutory standpoint.

B. Employee Best Interests and Ancillary Benefit to the Employer

ERISA's "Exclusive Benefit Rule"[144] requires fiduciaries to act "for the exclusive purpose of: (i) providing benefits to participants

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142. 62 F.3d at 572.

143. Crowley v. Corning, Inc., No. 02-CV-6172 CJS, 2004 U.S. Dist. LEXIS 758, at *20–23 (W.D.N.Y. Jan. 14, 2004); *In re* WorldCom, Inc., 263 F. Supp. 2d 745, 764–65 (S.D.N.Y. 2003).

144. *See generally* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105 (1988) (explaining why "the central concept of ERISA fiduciary law, the exclusive benefit rule, misdescribes the reality of the modern pension and employee benefit trust").

and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."[145] These obligations were modeled after trust law's duty of loyalty. Trust law, however, normally forbids an individual from acting as a trustee if the individual has a conflict of interest with the trust. In contrast, ERISA permits fiduciaries to take on conflicting roles, such as that of employer and plan fiduciary.[146]

ERISA's provision for conflicted fiduciaries required the courts to resolve whether an advantage that flows to the company sponsoring a benefit plan is a violation of the Exclusive Benefit Rule. The argument for a violation is that the Exclusive Benefit Rule establishes a standard of an "eye single" to the interests of plan participants and beneficiaries.[147] In theory, any benefit to the employer would be inconsistent with this standard.

The Supreme Court accepted the opposing argument and decided that a benefit plan sponsor may receive "'incidental' . . . benefits . . . from the operation of a pension plan."[148] This approach recognizes both the statutory approval of conflicted fiduciaries and the practicality that employers sponsor benefit plans for a variety of self-interested reasons. In *Hughes Aircraft Co. v. Jacobson*, the Court reiterated its position that receipt of "incidental" benefits by a plan sponsor does not breach ERISA's fiduciary provisions and enumerated a list of practical goals, such as employee retention, labor relations goals, and decreasing lawsuits by employees in downsizing situations, that an employer might legitimately hope to achieve through use of a pension plan.[149]

It is interesting to consider how the cultural considerations discussed above might affect allegations that employers use company stock in 401(k) plans to benefit the employer rather than with an "eye single" to the benefit of employees. The employer's goals in using employer stock might include such now familiar goals as aligning employee and employer interests or placing stock in the hands of employees to protect against hostile takeover attempts. Generally, goals of the former sort would seem consistent with those the Supreme

145. Employment Retirement Income Security Act of 1974 (ERISA) § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (2000).
146. Dana M. Muir, *Fiduciary Status as an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391, 414 (2000).
147. Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).
148. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 445 (1999) (quoting Lockheed Corp. v. Spink, 517 U.S. 882, 893 (1996)).
149. *Id.*

Court has accepted as legitimate incidental benefits. Dr. Hofstede's measure of the United States as being high on individualism would support the notion that an employer might be able to counter this cultural factor through the use of company stock to increase collectivism.

The larger question, on which the Supreme Court has not provided guidance, is at what point the employer's use of company stock might exceed the standard of "incidental" benefits. A possibility implied by the Supreme Court's use of the term "incidental" in its approval of the advantages that flowed to the employer in *Hughes* is the use of a balancing approach. One definition of "incidental" states that it is something "subordinate, nonessential, or attendant in position or significance."[150] Application of the incidental limitation in this way to evaluate the use of company stock would be consistent with the notion that the core purpose of a benefit plan must be to provide benefits to its participants and beneficiaries. Thus, unless the employer's primary purpose in using company stock is to provide benefits to the participants and beneficiaries, the use of company stock would violate the Exclusive Benefit Rule. Similarly, using company stock in 401(k) plans for the explicit purpose of protecting against hostile takeover attempts would be controversial, particularly given the argument that enabling corporate control contests maximizes firm value. If one looks cumulatively at all of the positive business effects employers might achieve through use of company stock in 401(k) plans, it is possible the total effect could exceed the incidental standard established by the Supreme Court.

A related argument regarding the potential liability for employers that use company stock in 401(k) plans relies on the settlor doctrine. In a trilogy of cases, the Supreme Court determined that plan sponsors do not act as ERISA fiduciaries when they are establishing, amending, or terminating a benefit plan—the categorization of actions known as settlor actions.[151] According to *Hughes,* the doctrine applies to 401(k) plans that are funded with employee contributions.[152] In the words of the Supreme Court: "ERISA's fiduciary duty requirement simply is not implicated where [the employer], acting as the plan's

150. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY, *supra* note 5, at 1142.

151. *Hughes*, 525 U.S. 432 (settlor doctrine applied to contributory retirement plan); *Lockheed Corp.*, 517 U.S. 882 (settlor doctrine applied to noncontributory retirement plan); Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73 (1995) (settlor doctrine applied to retiree health care plan).

152. *Hughes*, 525 U.S. at 444.

settlor, makes a decision regarding the form or structure of the plan such as who is entitled to receive plan benefits and in what amounts, or how such benefits are calculated."[153]

In 401(k) cases alleging fiduciary violations due to the use of company stock, employers typically argue that the use of the stock is compelled by the terms of the plan. Since establishing the terms of the plan is not a fiduciary function, so the argument goes, the use of company stock cannot give rise to a fiduciary violation. The cases to date have not progressed beyond the stage of motion to dismiss, with some of the decisions being dependent on whether the plan terms accorded discretion on the use of company stock.[154]

V. Conclusion

Use of company stock in 401(k) plans in the United States has given rise to considerable litigation and policy debate in recent years. Considering the implications of company stock in 401(k) plans in light of the historical context of employee ownership, the cultural dimensions that define the United States, and the actual investment behavior of employees provides a new perspective on the issues.

Using Dr. Hofstede's evaluation of the United States along cultural dimensions to determine the expected interests of employees reveals that the use of company stock in 401(k) plans may be inconsistent with the interests and expectations of employees. On the other hand, there are strong indications that employers may be especially attracted to the use of company stock to counter cultural dimensions—such as encouraging workforces to act more collectively and increasing employee loyalty. The cultural considerations may help to explain the depth of the tension between employer goals and employee expectations. This also may contribute to the understanding of what appears to be irrational employee investment decision making.

Similarly, considering the cultural dimensions observed in U.S. society and the research on employee investment decision making may provide insight into litigation issues that have arisen in the company stock cases. The presumption of prudence that often is used in ESOP cases is less appropriate in the employer stock cases. In these cases the statute does not require the use of company stock and cul-

153. *Id*.
154. *See* Muir & Schipani, *supra* 59, at 323–24.

tural dimensions appear to contribute to questionable investment decision making by employees. Similarly, historical attitudes toward employee ownership and cultural dimensions may affect the evaluation of whether an employer fulfills its fiduciary duty when it decides to use company stock in its 401(k) plan.