Enron, Global Crossing, and Beyond: Implications for Workers

Susan J. Stabile
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INTRODUCTION

Within the last nine months, we have been bombarded with news of financial scandals involving large publicly held U.S. corporations. The collapses of companies such as Enron and Global Crossing are not aberrations. Instead, they are the direct result of managerial behavior aimed at short-term profit maximization. That behavior, in turn, is a predictable consequence of executive pay structures that measure and reward performance based on short-term financial results. Managers are under pressure to produce the financial results that Wall Street expects to see in order to continue to be generously rewarded.

Whatever other consequences flow from such behavior, workers suffer tremendously. Workers are sold on the benefits of investing in company stock, an investment that in reality is largely intended to benefit management. Although workers benefit when the value of a company’s stock rises, they suffer disproportionately compared to executives in the case of stock failure. Not only are executives in a far better position to know when to sell company stock than are workers, but workers are sometimes prevented from selling their largest stakes in employer securities through lock downs of their 401(k) plans, such as in the Enron context. Further, corporate employers often encourage workers to invest and stay with their

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investment in company stock, even as managers sell off their own equity holdings.

This Article discusses the link between the pay structure of executives and the type of behavior that led to the collapses of companies like Enron and explores the reasons why workers, those least able to protect themselves, are disproportionately harmed when such collapses occur. It then considers various means to better protect workers.

I. EXECUTIVE PAY AND EXECUTIVE MISBEHAVIOR

Over the last twenty years, in response to shareholders' complaints that executives were being paid like bureaucrats and lacked sufficient incentives to act in the best interests of shareholders, an increasing piece of executives' compensation has taken the form of contingent compensation rather than base pay. Specifically, stock options have grown to represent the major component of executive pay. The median value of stock options granted to CEOs in 1999 ranged from a low of 89% of the CEO's salary to a high of 245% of the CEO's salary.

Theoretically, contingent compensation should align the interests of executives with those of shareholders. The thought behind compensating with stock options is that if the shareholders do well, executives gain and if the shareholders do

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3 See Michael E. Mooney, Mitigating the Pain of Equity Compensation in a Down Market, TAX NOTES, Nov. 19, 2001, at 1099. The average stock option award to CEOs in that year—measured by stock price times number of shares—was ten million dollars, more than twice the value of awards made only three years earlier. See id.
not do well, executives do not gain. Other types of contingent bonus arrangements achieve the same result by conditioning bonus payments on achievement of certain performance targets. Unfortunately, neither side of that equation works perfectly.

First, as I have explored in more depth elsewhere, manipulation of contingent compensation arrangements means that executives do not necessarily suffer financially when the stock price of a company falls. For example, practices like repricing options have the effect of eliminating any risk that option compensation puts on executives.

Second, and more importantly for purposes of this discussion, excessive reliance on incentive compensation creates the wrong incentives for executives. Even at the most benign level, placing significant portions of an executive's pay at risk encourages risk taking and an emphasis on short-term stock rises that gives insufficient attention to the company's long-term best interests. Executives who receive the bulk of their pay in the form of stock options have “enormous incentive to get the stock price up in time to cash in their options.”

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7 See, e.g., Lucian Ayre Bebchuk et al., Managerial Power and Rent Extraction in the Design of Executive Compensation, 69 U. CHI. L. REV. 751, 765 (2002) (citing options repricing and granting of reload options as illustrative of power CEOs exercise over the design of executive compensation packages). Indeed, many take it as a given that adjustments must be made to mitigate the pain to executives caused by a decline in stock value. See Mooney, supra note 3, at 1099 (discussing ways to mitigate the adverse impact of falling stock prices on executives).
8 See A.B.A. TASK FORCE ON CORP. RESP., PRELIMINARY REPORT 8 (July 16, 2002) (stating that an unanticipated consequence of the growth of equity-based compensation is a powerful incentive for executive officers to meet Wall Street earnings expectations and avoid negative impact on current stock prices); DEREK BOK, THE COST OF TALENT 245 (1993) (finding that overly large rewards may tempt people to engage in strategies that are not necessarily in the company's best interest); Adam Bryant, Feeding the New Work Ethic, N.Y. TIMES, Apr. 19, 1998, at 1 (noting that options provide incentives for CEOs to take steps to boost stock price, such as engaging in acquisitions and divestitures).
9 Paul Krugman, The Outrage Constraint, N.Y. TIMES, Aug. 23, 2002, at A17. Krugman's article also discusses corporate programs of acquisition and expansion
It is, of course, difficult to prove that executive pay plans caused certain corporate action. It is not difficult, however, to find examples that suggest exactly that. For example, is it coincidence that, following Bristol-Myers' adoption of a new long-term incentive plan that based awards on sales growth, the company began to use incentives to induce its wholesale customers to buy more products than they needed?\(^\text{10}\) The practice tremendously boosted sales for the year, which resulted in large executive bonus payments.\(^\text{11}\) It also, however, resulted in the company's wholesalers holding hundreds of millions of dollars of excessive inventory, the effect of which will be reduced revenue in this year.\(^\text{12}\)

Less benignly the use of options as "a system that lavishly rewards executives for success tempts those executives, who control much of the information available to outsiders, to fabricate the appearance of success. Aggressive accounting, fictitious transactions that inflate sales, whatever it takes."\(^\text{13}\) The shift from the heavy use of fixed compensation to increasing reliance on incentive pay has been accompanied by increasing incidents of misrepresentative accounting and other improprieties on the part of corporate executives.\(^\text{14}\) Even in the absence of actual fraud, executives are tempted to take—and do

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\(^{11}\) Id.

\(^{12}\) Id.

\(^{13}\) Paul Krugman, *Greed Is Bad*, N.Y. TIMES, June 4, 2002, at A19; see also BOK, *supra* note 8, at 245 (pointing out that it is difficult to set rewards "large enough to motivate effectively but not so large as to tempt people to resort to improper or even illegal behavior to qualify"); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 U. CHI. L. REV. 1233, 1247 (2002) (discussing the fact that executives with high amount of option compensation have an incentive to use any means they can to increase stock price, including fraud and excessive risk-taking); Detlev Vagts, *Challenges to Executive Compensation: For the Market or the Courts*, 8 J. CORP. L. 231, 242–43 (1983) (noting that earnings-based compensation plans may drive executives towards illegal actions because compensation plans are calculated on increasing profits and annualized earnings figures that are manipulable).

\(^{14}\) See Krugman, *supra* note 13, at A19 (noting that "statistics for last five years show dramatic divergence between the profits companies report to investors and other measure of profit growth"); Krugman, *supra* note 9, at A17 (observing that despite the fact that national statistics show that corporate profits grew very little over the last few years, most large public companies reported double-digit profit growth in each of the last few years).
take—what, at best, can be described as aggressive positions. Thus, for example, Merck & Company, which utilized an executive bonus plan based on comparing the company's growth in its revenue and earnings to that of its health care peers, last year included fourteen billion dollars in revenue in prescription co-payments that the company never received and that are not reflected in the company's net income. Similarly, in 1998 Green Tree Financial Corporation was forced to restate its 1996 profits resulting in its CEO having to pay back a significant portion of his 1996 bonus payment. This occurred after shareholders accused the company of using overly aggressive accounting methods to boost profits—and therefore the CEO's bonus.

II. DISPROPORTIONATE IMPACT OF EXECUTIVE MISBEHAVIOR ON WORKERS

A. Overselling Employees on the Value of Investing in Company Stock

There may be legitimate reasons not to give employees a financial stake in the fortunes of the employer. Doing so allows employees to share in corporate prosperity. It also induces employees to perform by allowing them to benefit from corporate gains. Certainly employers believe that providing employees with stock will promote loyalty and productivity.

Moreover, there is some evidence that supports this belief. For example, one study evaluating the effect of broad-based employee stock

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15 See Morgenson, supra note 10, § 1 (also citing belief of Merck's general counsel that the accounting accurately reflected the company's results).

16 See Martha M. Hamilton, Bonus King to Pay Back Chunk of $102 Million Take, WASH. POST, Jan. 29, 1998, at E1 (suggesting that the company's compensation arrangements gave CEO Coss the incentive to back such optimistic accounting arrangements); Adam Zagorin, Too Good to be True: Larry Coss, the Prince of Pay, Must Give Back a Chunk of His Bonus, TIME, Feb. 23, 1998, at 47 (noting that the company denied that its accounting methods were designed to increase profit and the CEO's pay).

17 See U.S. DEPT OF THE TREASURY, EMPLOYER STOCK IN 401(K) PLANS 3 (Feb. 28, 2002) (discussing employer beliefs regarding value of employee holdings of company stock); Robert Luke, Workers Still Want Company Stock Despite Enron Fall, ATLANTA J. & CONST., Feb. 1, 2002, at 1C (citing the president of 401(k) Association regarding employer expectation that "employees with an ownership stake are more loyal and productive. . . . and that senior management . . . likes stock to be in friendly hands").
option plans on corporate performance found that companies with such plans have significantly higher productivity as compared to public companies as a whole and peer companies as a group.\(^\text{18}\)

Giving employees a meaningful stake in their employer is one thing; giving them a disproportionate stake, however, is another. A broader range of employees is beginning to receive increasing numbers of stock options and bonus stock as a component of their compensation.\(^\text{19}\) In addition, we have reached a point where the 401(k) plan accounts of a significant number of employees are bloated with company stock.\(^\text{20}\) Workers whose companies offer an employer stock fund, which includes 401(k) plans of most large public enterprises, direct an average of about thirty to forty percent of their contributions to their employer's stock.\(^\text{21}\) These high concentrations still exist despite

\(^\text{18}\) See Joseph Blasi et al., *Broad-Based Stock Options and Company Performance: What the Research Tells Us*, in *JOSEPH BLASI ET AL., STOCK OPTIONS, CORPORATE PERFORMANCE, AND ORGANIZATIONAL CHANGE* 14 (2000) (finding 38% higher productivity than all public companies and 37% higher than peer group); *see also* John Core & Wayne Guay, Stock Option Plans for Non-Executive Employees, 4 (2000) (working paper, on file with author) (noting that although lower-level employees may not influence stock price through individual action, granting of stock options "potentially induces mutual monitoring and thereby improves group incentives"). The evidence on this part is far from uniform, with others finding less evidence of positive gains flowing from broad-based employee stock ownership. *See Joseph Blasi et al., Employee Stock Ownership and Corporate Performance Among Public Companies*, 50 INDUS. & LAB. REL. REV. 60, 63–64 (1996) (discussing prior studies of broad based employee stock ownership and finding that "the very dispersed results reported by prior studies leads to no overall conclusion that employee ownership is associated with better or worse performance"); Charles D. Ittner et al., *The Structure and Performance Consequences of Equity Grants to Employees of New Economy Firms* 33 (Jan. 2000) (working paper, on file with author) (reporting study findings that grants to lower level employees are not positively associated with increases in shareholder value).

\(^\text{19}\) See Geeta Sundaramoorthy, *Executive Pay Rides High on Options*, BUS. NEWS, June 27, 2000, at 6 (reporting findings of the National Center for Employee Ownership that the number of employees who have been granted stock options by their employers has grown from about one million in 1992 to about ten million today).

\(^\text{20}\) Some would argue that no 401(k) plan assets should be invested in company stock. As Professor Shlomo Benartzi explains, "'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.'" *Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans*, INST. OF MGMT. AND ADMIN (IOMA), DC PLAN INVESTING, Dec. 11, 2001, at 1,7 [hereinafter Enron Debacle].

\(^\text{21}\) *See id.* at 3 (noting that in plans with 5000 or more participants, company stock accounts for 43% of total plan assets); *Company Stock Investment Remains Too High In Over Half of Plans Tracked*, IOMA DC PLAN INVESTING, Aug. 13, 2002,
the bad publicity that surrounded the losses to plan participants caused by the fall of companies like Enron.\textsuperscript{22} In addition to employees’ own contributions, many companies require that employer matching contributions be invested in employer securities, resulting in even higher accumulations.\textsuperscript{23} This puts a significant portion of a participant’s retirement assets at risk when a company suffers a financial downturn.\textsuperscript{24}

It should come as no surprise that employees voluntarily put so much of their future financial security at the hands of the future performance of their employer. Adding to employees’ feelings of loyalty to the employer,\textsuperscript{25} employers continually tout at 1–2 (stating that as of August, average investment of all participants in plans with an employer stock fund was 28%). Many participants have account balances that far exceed the average. See id. (highlighting that participants employed by a dozen of 318 surveyed sponsors have more than 75% of their 401(k) account balance in company stock).

\textsuperscript{22} See Workers Need to Invest Wisely, ATLANTA J. & CONST., Aug 30, 2002, at 21A (reporting IOMA and Hewitt survey results that workers continue to overinvest in employer securities); see also Christine Dugas, Company Stock Still Fills Many 401(k) Plans, USA TODAY, Aug. 26, 2002, at 1B; John Wasik, Weaning Employees off Their Employer, FIN. TIMES, Aug. 21, 2002, at 22 (reporting results of Hewitt study showing that majority of surveyed employees still believe company stock is as safe an investment as a money-market mutual fund and that one-fifth of employees 60 and older had all their 401(k) assets in company stock).

\textsuperscript{23} This results both from the effect of the match itself and because participants in plans that require a match in employer securities tend to invest a higher percentage of their self-directed funds into company stock than participants in plans that do not have the required match feature. See The Role of Company Stock in 401(k) Plans, Retirement Security: Picking up the Enron Pieces: Hearing Before the Senate Comm. on Fin., 107th Cong. 5 (2002) (statement of Jack L. VanDerhei) (finding that company stock represents 33% of a participant’s account balance in plans where company match must be invested in company stock versus 22% in plans lacking that requirement); Sarah Holden & Jack VenDerhei, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 1999, EMPLOYEE BENEFIT RES. INST. (EBRI), Feb. 2001, at 13 (finding that where plans require that company matches be invested in company stock, participants tend to direct a higher percentage of their self-directed funds into that option as well).

\textsuperscript{24} To give some examples from a recent Institute of Management and Administration study: Coca-Cola Co.’s 401(k) plan is 81% invested in company stock and the stock declined 22% in 2001; Texas Instruments, 75% invested in company stock, stock down 32%; Williams Cos., Inc. 75% invested in company stock, stock down 33%; McDonald’s Corp., 74% invested in company stock, stock down 21%. See Enron Debacle, supra note 20, at 2.

It is also worth noting that the incentive justification for employee stock ownership operates less strongly with respect to stock held through 401(k) plans than direct holdings of stock or stock options. See Gordon, supra note 13, at 1248–49.

\textsuperscript{25} Many employees invest heavily in employer stock out of a sense of loyalty to their employers. See Lewis Braham, Institutional Asset Management: The Growing
the value of holding company stock, as evidenced by the numerous press reports of statements made by Enron executives to rank and file employees during 2001. Even worse, many believe that companies do more than "objectively" tout the value of company stock. During a press conference held in March of this year, Senator Ted Kennedy expressed his belief that "the main reason why Enron workers lost more than a billion dollars is that they were pressured by Enron executives to put all their 401(k) money in company stock." Allegations of such employer pressure as well as of misrepresentations designed to induce employees to remain invested in company stock have been advanced not only in lawsuits commenced against Enron, but also in a number of lawsuits that have been filed against other employers by participants who have suffered heavy plan losses as a result of downturns in the employer's stock. Certainly, 

Number of Options in Qualified Plans Is a Boon for Planners in the Short Run But Could Spell Trouble in the Long, FIN. PLAN., July 1, 1997, available at 1997 WL 10306217, at *7 (explaining that despite lack of diversification, employees over-invest in employer securities because "often even the most sophisticated employees remain doggedly loyal to their mother company"); Adam Bryant, Betting the Farm on Company Stock, N.Y. TIMES, Apr. 16, 1995, § 3, at 1 (stating that for many employees, the issue is emotional; employees invest heavily in employer securities even though they say they would never advise a relative to be so heavily invested in a single stock). As one employee explained, "I was loyal to the company. The CEO said the company stock would turn around. I'm sorry to say I believed him." Keith Herbert, WorldCom Victim Shares NCC Stage with Democratic Candidate, MORNING CALL, Aug. 28, 2002, at B6. Other employees feel that they "owe something to the company" and therefore should invest in company stock. Susan Strother Clarke, Area Workers' 401(k)s Bet on Employer Stock, ORLANDO SENTINEL, Mar. 3, 2002, at A1 (quoting Professor Patricia Dilley).

See Am. Ampl. ¶¶ 240–73, Tittle v. Enron, No. 01-CV-3913 (S.D. Tex. Filed Nov. 28, 2001) [hereinafter Amended Complaint].


For example, a lawsuit filed against Lucent Technologies alleges such manipulation. See Reinhart & Smith v. Lucent Tech., Inc., No. 01-CV-3491 (D.N.J. 2001). The complaint alleges that Lucent induced plan participants to invest in, or continue to invest in, Lucent stock despite the fact that the company knew of serious business problems that would adversely affect the value of the stock. A similar such action was brought against Ikon Office Solutions, and a class certified in 2000. See In re Ikon Office Solutions, Inc., 191 F.R.D. 457, 459–60 (E.D. Pa. 2000). The Ikon litigation was recently settled, with the company agreeing to make certain changes to its 401(k) plan, including allowing participants with at least two years of service to invest company matching contributions in funds other than employer securities. See Ikon Office Solutions, Ikon Settles ERISA Litigation (May 14, 2002), available at http://www.ikon.com/reading/press-releases/releases/
practices like requiring matching contributions to be invested in company stock and offering company stock at a discount to employees\textsuperscript{30} suggest employer attempts to influence employees to invest in such stock.\textsuperscript{31}

It is not difficult to understand why executives might be motivated to exert such pressure. Stock in the hands of employees is stock in friendly hands.\textsuperscript{32} Employers believe that employees will be more concerned with current job security than with the future value of their retirement benefit and thus will make voting and tender decisions that favor the interests of current management.\textsuperscript{33} There is good basis for that belief. Employees often have strong feelings of identification with their employer and "derive psychological or emotional benefit from making decisions they perceive to be in the best interests of current management."\textsuperscript{34} At a minimum, employee shareholders are less likely to be vocal antagonists to management positions. According to survey results of the Employee Benefit Research Institute, sixty-five percent of surveyed plan participants indicated that they would not vote in favor of an acquisition of their employer by a hostile acquirer even if doing so would result

\textsuperscript{30} See Jeffrey N. Gordon, Employees, Pensions and the New Economic Order, 97 COLUM. L. REV. 1519, 1555-56 (1997) (suggesting that one of the reasons so much 401(k) money is invested in employer securities is that employers often offer stock to employees at a discount).

\textsuperscript{31} See Pension Institute, Olivia S. Mitchell & Stephen P. Utkus, Company Stock and Retirement Plan Diversification, Apr. 2002, at 31, 34, available at http://prc.wharton.upenn.edu/prc/PRC/WP/WP2002-4.pdf (noting that employees may be "encouraged through management promotion of the stock, and possibly organizational pressure to buy and own shares in the company"). Employers certainly have an incentive to pressure employees. As one commentator observed, "If you take a company that has 30,000 or 40,000 employees, and all of those people are buying the stock, that supports the price and makes the company look better. A lot of CEOs get paid on the basis of the stock price, so there's an incentive to do that." Ed Taylor, Pension Groups Worry About Congressional Interference after Enron, EAST VALLEY TRIBUNE BUSINESS NEWS, Mar. 4, 2002 (quoting James Dew, director, Financial Planning Association), available at www.lexis.com.


\textsuperscript{33} See id.

\textsuperscript{34} Id. at 103.
in a fifty percent return on their investment, and fifty-six percent said they would not do so even for a one hundred percent return on their investment.\textsuperscript{35}

B. Employees Lack Executives' Ability to Protect Themselves

To be sure, executives have significantly greater holdings of company stock than do rank and file employees.\textsuperscript{36} A precipitous decline in the value of the company's stock, however, poses far greater risk for rank and file employees than for executives.

First, whereas the largest executive holdings are in the form of stock options, the largest accumulations for rank and file employees are in company stock held in a 401(k) plan account.\textsuperscript{37} When the company's stock price falls, the executive has simply lost the potential gain from stock options. Even that is not guaranteed, given the frequent practice of repricing options.\textsuperscript{38} For employees who hold actual stock in their 401(k) plan, however, there is a real loss. For example, Enron's 401(k) plan lost approximately $1.3 billion in value between January 2001, when the stock traded at eighty dollars per share, and December 2, 2001, when it traded at less than one dollar per share. As a result, many participants lost between seventy and ninety percent of their retirement funds.\textsuperscript{39}

Second, executives have greater access to information that gives them earlier warning that selling company shares may be desirable.\textsuperscript{40} At best, executives fail to share this information; at worst, they deliberately hide it. Lawsuits filed against Enron, Global Crossing, and other companies charge that

\textsuperscript{35} Public Attitudes on Employee Ownership and Benefit Promises, EBRI, 1994, at 22.
\textsuperscript{36} See David Leonhardt, Stock Options Said Not to Be As Widespread As Backers Say, N.Y. TIMES, July 18, 2002, at C1.
\textsuperscript{37} See Susan J. Stabile, Another Look at 401(k) Plan Investments in Employer Securities, 35 JOHN MARSHALL L. REV. 539, 542 (2002) (noting that many 401(k) plans are heavily invested in employer securities).
\textsuperscript{38} See Pallavi Gogoi, When Good Options Go Bad, BUS. Wk., Dec. 11, 2000, at 96 (giving examples of companies that have repriced existing options or granted new options because of stock price decline).
\textsuperscript{39} See Richard A. Oppel, Jr., Employees' Retirement Plan Is a Victim As Enron Tumbles, N.Y. TIMES, Nov. 22, 2001, at A1 (discussing losses suffered by Enron employees who invested their savings in Enron's 401(k) retirement plan).
\textsuperscript{40} See Myths and Realities of Executive Pay: Hearing Before the Senate Comm. on Fin., 107th Cong. 5 (2002) (statement of Ira T. Kay, Practice Director, Compensation Consulting, Watson Wyatt Worldwide).
misrepresentations encouraged participants to invest in company stock and to continue investing even when their company faced financial trouble. They also claim that the companies withheld information about the companies' worsening financial situation.

Again, the example of Enron is illustrative. Via an internal company newsletter, Enron 401(k) plan participants received the same inflated earnings statements for the years 1997 through 2000 that were disclosed to the company's other shareholders. In addition, they also received numerous communications through e-mails, company newsletters, and employee meetings touting the future prospects of the company's stock. CEO Ken Lay reportedly sent employees a letter on August 14, 2001 acknowledging that stock prices had suffered over the last few months, but noting that the company's performance had never been stronger and its growth never more certain. It appears that Lay continued to make such statements even after receiving a memorandum in August from Sherron Watkins, Enron's Vice-President of Corporate Development, which raised the fact that several senior company officials had questioned the company's accounting methods, including the fact that the partnership accounting arrangements had inflated the value of Enron stock. There seems to be little question that employees were not privy to the same information about the company's true financial state that was available to senior executives, many of whom were selling a significant amount of their own shares even as they were continuing to tell employees what a good investment the company's stock represented.

Third, employees may not be free to sell company shares held in their 401(k) plan account. Many 401(k) plans require that any matching contributions be made in company stock.

\[\text{42 Id.}
\[\text{43 See Amended Complaint ¶ 204–39.}
\[\text{44 Id. ¶¶240–73.}
\[\text{45 Id. ¶ 267.}
\[\text{46 Id. ¶¶268–69.}
\[\text{47 Id. ¶ 269.}
\[\text{48 See Theo Francis, Company Stock Fills Many Retirement Plans Despite the Potential Risks to Employees, WALL ST. J., Sept. 11, 2001 (noting that many employers match employee 401(k) contributions with company stock, giving Gillette,}\]
Typically, such plans also contain a requirement that such shares cannot be diversified until the participants reach a certain age. Enron’s 401(k) plan, for example, prevented participants from disposing of Enron shares acquired from matching contributions until age fifty. Thus, even if Enron employees had been aware of the magnitude of the company’s financial difficulties, they would have been unable to sell those shares.

Moreover, as was also the case with Enron, even though participants are generally free to sell shares attributable to their own plan contributions, they are sometimes prevented from doing so. Allegations against Enron include claims based on a lockdown, or a suspension of plan trading that prevented participants from transferring funds out of company stock while stock value declined sharply.

It is true that executives holding matching shares in their 401(k) plan are subject to the same limitation on trading employer securities acquired by virtue of a company matching contributions and to the same prohibition on trading during a lockdown as are rank and file employees. Executives, however, tend to have a very small portion of their total retirement assets

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49 See Purcell, supra note 48, at 6 (noting that 34% of companies that match in company stock require participants to reach a certain age—typically 50 or 55—before they can sell the stock).


51 On October 17, 2001, the account balances of Enron’s 401(k) plan participants were frozen, preventing them from moving their plan assets between plan funds. On that day, Enron’s stock was trading at $32.30/share. During the period participants were prevented from moving assets out of the company stock fund, the value of the stock dropped precipitously. See Enron Debacle, supra note 20, at 1, 3; Susan J. Stabile, Lessons from Enron: Special Supplement to 401(k) Plan Answer Book E-1 (2002) (discussing dispute between company and employees regarding actual dates of lockdown).

Lockdowns themselves are not problematic and are, indeed, a routine occurrence in 401(k) plans. According to one survey, 74% of responding plans had undergone at least one lockdown, and on any given business day, almost 100 plans are in a lockdown situation. The problem arises if the company’s stock fluctuates dramatically during the period in which participants are prohibited from trading shares. Id.
in their employer's qualified plan and thus are much less affected by the operation of such a restriction. 52

C. Female Employees May Be the Most Vulnerable

Sufficient 401(k) plan accumulations are particularly important for female employees. Not only do women have longer life expectancies than men, 53 but their shorter tenure in the workforce and lower wages generally result in lower Social Security entitlements. 54 Women also generally have less personal savings. 55 Thus, women both need more money to support themselves during their retirement and have less sources of retirement income than men.

It does not appear from the statistical evidence available that women are any more likely to initially invest in employer securities than are men. 56 There are, however, reasons to think women are less likely to move out of their company stock investments as quickly as men when their employer faces difficulties. Those reasons have nothing to do with lack of familiarity with general investment principles, although there is certainly evidence that women do not have as sophisticated financial and investment knowledge as do men. 57 Instead, the

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53 See 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, 16–17 (2002) (observing that women need a longer stream of retirement income because they have significantly longer life expectancies than do men); see also CENTERS FOR DISEASE CONTROL, NATIONAL HEALTH CENTER FOR HEALTH STATISTICS, available at http://www.cdc.gov/nchs/fastats/lifeexpect.htm (stating that as of 2000, American females have a life expectancy at birth of 79.5 years while American males have a life expectancy of 74.1 years).

54 See Muir, supra note 53, at 16 (noting that because of lower compensation, more part-time work and more breaks in work history, women have lower Social Security entitlements than do men).

55 See id. (explaining that women have fewer personal assets than do men).

56 See Colleen E. Medill, The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality, 49 EMORY L.J. 1, 22 (2000) (citing findings of Bajtelsmit and VanDerhei that male and female employees have similar investment allocations to company stock, with males investing 41% of their account balance in company stock and females investing 42%); Jane Bryant Quinn, Investing Isn't About Sex, WASH. POST, Feb. 18, 2001, at H2 (noting that men tend to be heavier investors in company stock than women).

57 See Preparing for Retirement: 1000 Americans, Towers Perrin in CCH PENS. PLAN GUIDE ¶26,549 (reporting survey findings that males report greater
reasons are more behavioral in nature.

First, women generally trade securities less frequently than men, favoring a more long-term or relational approach to investment.58 This is an investment trait that generally works to women's benefit.59 In the case of employer securities, however, it may lead them to stay with their employer investments longer than is wise.

Second, women tend to have greater loyalty.60 They are thus more likely to be susceptible to efforts by employers to encourage employees to remain with their company stock investments.

Women are also more risk averse, tending to be more conservative investors.61 It is less clear, however, how that conservatism plays out in the context of employer securities. Women may perceive that during times of financial turmoil, remaining invested in their employer is a safer bet. On the other hand, it may be that women are quicker to learn from the experience of companies like Enron and Global Crossing that an

familiarity with investment principles than female survey participants); Bryant Quinn, supra note 56 (commenting that women on average are less exposed to investing than men and thus have "less stock market know-how").

58 See Jerry Morgan, Mind Games: Behavioral Finance Is Helping to Open the Door into What Kind of Investor We Are and Why, NEWSDAY, Dec. 19, 1999, at F6 (noting that men trade more frequently than women).

59 See Bryant Quinn, supra note 56 (observing that "the less you trade, the better you do."); Morgan, supra note 58 (because men trade more frequently, they have higher costs and are more likely to sell at the wrong time).

60 See Debora Vrana, Investing with Cash, Hearts and Souls, L.A. TIMES, Feb. 25, 1997, at A1 (quoting the observation of financial planner Esther Berger that "[w]omen invest with their souls and their hearts rather than their pocketbooks alone"). Evidence for this loyalty is seen in how women talk about their employer. See, e.g., Hearing Before the Senate Governmental Affairs Comm., 107th Cong. 2–3 (2002) (statement of Deborah G. Perotta, a former senior administrative assistant at Enron, referring to Enron as a family that rewarded employee loyalty and hard work with large compensation and benefits packages which, in turn, "created an atmosphere of great pride, trust and respect"); Anthony Violanti, Enron's Crash Turned Media 'From Lap Dogs to Attack Dogs,' THE BUFF. NEWS, Feb. 15, 2002, at C4 ("What hurts almost as much ... is that working at 'Enron was like being part of a community. We cared about each other.' " (quoting former Enron employee and single mother, Helen Matthews)).

61 See GENERAL ACCOUNTING OFFICE (GAO) REP. 96–176, 401(K) PENSION PLANS—MANY TAKE ADVANTAGE OF OPPORTUNITY TO ENSURE ADEQUATE RETIREMENT INCOME, 24–25 (Aug. 1996) (finding that female workers tend to be more conservative investors than males, particularly women in the 51–61 age bracket); Muir, supra note 53, at 17 (noting that studies of investment behavior "uniformly find that women have a lower tolerance for risk than do male investors"); Women in Retirement, FACTS FROM EBRI, Nov. 2001, at 4 (finding women to be more conservative investors).
investment in their employer is a riskier proposition than they thought.

D. Why This Disproportionate Impact Should Be of Concern

It should disturb us that workers are disproportionately adversely affected by corporate failures such as Enron and Global Crossing. Apart from our moral outrage that those who have a hand in the failures are left largely unscathed while innocent employees suffer,62 two other serious problems flow from the disproportionate impact on workers.

The first is an aggravation of the rising gap in pay between executive and rank and file workers. We have already reached a point where the average pay of a CEO is anywhere from 475 to 500 times the pay of average employees.63 As I have explored in more detail elsewhere, this enormous income inequality has adverse consequences for worker morale and productivity and for our broader concerns of distributive justice.64 These problems are obviously aggravated by the kinds of losses to employees that we are discussing here.

The second problem is a loss of retirement security, since most of the stock held by rank and file workers is held though their 401(k) plan accounts. Most Americans fail to accumulate significant retirement savings apart from their employer-

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62 Besides the fact that Enron executives sold massive numbers of shares while rank and file employees were locked into their 401(k) plan holdings, there are other respects in which Enron executives profited while rank and file employees suffered. These include newspaper reports that CEO Ken Lay will receive an annual pension of almost $500,000 a year and reports of large retention bonuses paid to certain executives. During the month prior to filing for bankruptcy, Enron paid more than $80 million to senior executives as retention bonuses. See Jeff St. Onge & Daniel Taub, U.S. Judge OKs Enron Severance Package, L.A. TIMES, Aug. 29, 2002, at C3. Under a recent court settlement agreement, employees can challenge these retention bonuses, and, if successful, divide the recovered money. See Severance Package from Enron is Set, N.Y. TIMES, Aug. 29, 2002, at C2. To employees who lost the bulk of their retirement savings and to those employees who were terminated and paid a pittance in severance—an average of $6,850 under a recent court settlement. See St. Onge, supra.

63 See Jennifer Reingold & Fred Jespersen, Executive Pay, BUS. WK., Apr. 17, 2000, at 100 (discussing that in 1999 the average CEO earned 475 times the average wage of a blue-collar worker); Runaway CEO Pay: What's Happening and What You Can Do About It, supra note 2 (citing Business Week to the effect that the average CEO made 531 times the average blue-collar's pay in 2000, compared to a multiple of 85 in 1990).

64 See Stabile, supra note 1 (discussing the consequences of widening gap in pay between executives and rank and file workers).
sponsored pension plans, and Social Security standing alone was never meant to provide an adequate standard of living in retirement.\(^6\)

It is thus important that employer-sponsored pension plan savings be sufficient to provide adequate retirement income.\(^6\) In this vein, we should be particularly troubled by the fact that low-wage workers—those least likely to have adequate alternative sources of retirement income—are “three to five times as likely to have 80 percent or more of their retirement plan savings in company stock” than high wage workers.\(^6\)

Thus, a significant loss in the value of company stock will have dire consequences for many low-wage employees.

This loss of retirement security is particularly problematic for women. Women already are the most vulnerable to retirement insecurity in the sense that they are less likely to participate in pension plans than are men.\(^6\) Those women that do participate have lower account balances than males\(^6\) as a

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6 Social Security provides an average of only 40% of pre-retirement income. See Democratic Leadership Introduces Clinton's Pension Reform Package, BNA PENSIONS & BENEFITS DAILY, May 28, 1996, at 23.


68 See GAO REP. TO THE RANKING MINORITY MEMBER, SUBCOMM. ON OVERSIGHT, HOUSE COMM. ON WAYS AND MEANS, H.R. GAO-01-846, PRIVATE PENSIONS: ISSUES OF COVERAGE AND INCREASING CONTRIBUTION LIMITS FOR DEFINED CONTRIBUTION PLANS, 10, 12 (Sept. 2001) (indicating that 44% of female employees participate in pension plans compared to 50% of male employees, due to the facts that “[w]omen workers' lower wages, greater concentration in part-time jobs, and greater concentration in industries where few employers offer pension plans”); Patrick J. Purcell, Pension Sponsorship and Participation: Summary of Recent Trends, CRS REP. FOR CONG., Oct. 4, 2001, at 14 (although women employed year-round, full-time, are now as likely as males to work for an employer that sponsors a retirement plan, they are slightly less likely than men to participate in these plans); Women in Retirement, supra note 61, at 2 (noting that women tend to work in sectors that do not sponsor retirement plans).

69 See Patrick J. Purcell, Retirement Savings and Household Wealth in 1998: Analysis of Census Bureau Data, CRS REP. FOR CONG., May 8, 2001, at 22 (average male worker has plan account balance that is $8730 higher than that of average female worker); Martha L. Stone, I'm in Charge Financially? Web Sites That Help Women Take Control of Their Fiscal Futures Are Becoming Abundant, CHI. TRIB., July 9, 1998 (noting that only 27% of women in 33–35 year age bracket have 401(k) plan account balances that exceed $100,000, compared with 43% of men); Women in Retirement, supra note 61, at 2 (reporting findings that women receive lower retirement benefits than do men); see also Allen R. Myerson, Wall Street Addresses
result of factors such as lower wages and more interruptions in their careers. Their greater need for retirement income, combined with their greater vulnerability to pressures to remain invested in company stock, make for a significant risk to their retirement security.

III. HOW DO WE BETTER PROTECT WORKERS?

It is a mistake to rely on the hope that executives will police their own behavior; the incentives not to do so are too great. Thus it is important that Congress take steps to more aggressively address executives’ incentives to engage in wrongdoing and provide better protection of workers. I have elsewhere discussed what some of these steps might be, which include changes in accounting principles designed to introduce more rationality into the awarding of option compensation, and outright limits on the acquisition of employer securities by 401(k) plan participants. Others, which have been put forth for Congress’s consideration, include improved disclosure of company financial affairs to employees and a requirement that employees be informed when executives and directors engage in stock sales.

It is true that Congress has moved to try to discourage wrongdoing by executives. The recently enacted Sarbanes-Oxley Act of 2002, which moved through Congress with record speed in an effort to bolster the confidence of investors, aims to prevent future business scandals by revising corporate governance

Women's Distinct Needs, NY TIMES, Jul. 31, 1993, at 33 (observing that women wait longer to start saving for retirement and then save less of their already lowered income than men).

See Lorraine Schmall, Women and Pension Reform: Economic Insecurity and Old Age, 35 J. MARSHALL L. REV. 673, 677 (discussing factors that contribute to the likelihood of old-age poverty of women).

Although bills have been introduced on a number of occasions that would require an accounting charge in connection with the granting of stock options, it is clear that many in Congress view this as a matter to be addressed by the Financial Standards Accounting Board and not by Congress. See Lee Michael Katz, The Senate's Quiet Man Hits a Homer, NAT'L JOURNAL, Aug. 3, 2002, at 2324-25 (quoting Sen. Sarbanes).


standards, adding new disclosure requirements, and significantly increasing penalties for corporate wrongdoing. Whether the Act succeeds in its aims remains to be seen. The fact is, however, that companies will continue to operate with an incentive compensation structure that encourages various forms of executive misbehavior.

The Sarbanes-Oxley Act contains only one provision directly related to the concerns discussed in this Article. The provision prohibits executives from selling shares of company stock during periods that 401(k) plan participants are disabled from trading plan shares because of a lockdown. As part of an overall solution, the provision is unobjectionable. Standing alone, however, it is akin to trying to put out a forest fire with a tin cup of water. The fact that executives sold their own shares during a period in which rank and file employees were prohibited from selling contributed to the outrage felt at the corrupt corporate behavior. Lockdowns, however, do not occur very frequently, and the inability of rank and file employees to be able to sell during a lockdown, as occurred with Enron employees, is only a very small piece of the problem.

Congress has shown very little interest in serious reform aimed directly at reducing the income inequality between executives and rank and file workers. Attempts to use the tax code to reduce income inequality by, for example, limiting deductibility of executive pay to a certain multiple of rank and file pay, have consistently failed over the years.

Regarding the abuses of stock option compensation, legislation continues to be introduced regarding the accounting

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treatment of stock options. There is nothing, however, to indicate that support can be garnered for passage of such a bill. During a time when most congresspersons were on vacation, a bill was introduced by Senator Wyden, which aimed at increasing shareholder oversight over stock option compensation and reducing the incentive of executives to take action to run up the company's stock price. No one, however, can seriously believe that this Congress will pass a bill requiring shareholder approval of all stock options, mandating longer vesting periods, and restricting the sale by executives of stock acquired upon option exercise.

In the wake of Enron, Congress has shown some interest in strengthening retirement security, but it is unclear whether it is prepared to enact major pension reform. Close to twenty different bills were introduced for 401(k) plan reform in the months following the December 2, 2001 bankruptcy filing of Enron. When I testified before the Senate Governmental Affairs Committee in February 2002, people in Washington spoke as though enactment of one of these bills was a foregone conclusion. Yet, at this point in time, it is clear that no law at all, let alone one that could be termed serious pension reform, will be enacted in the foreseeable future. The House passed its bill, the Pension Security Act of 2002, on April 11, 2002. The leading Senate bill, the Protecting America's Pension Act of 2002, has been reported out of Committee, but still awaits

76 See generally Amy Borrus & P. Dwyer, To Expense or Not To Expense, BUS. WK., July 29, 2002, at 44 (positing that stock options do not require cash costs, salary or bonuses); Richard S. Dunham et al., Reform Lite, BUS. WK., Apr. 2002, at 30 (discussing some objectives of President Bush following the rash of corporate scandals).


78 See STABILE, supra note 51, at E1–E18 (describing major features of bills introduced in the wake of Enron bankruptcy).

79 I say this notwithstanding recent statements by some congresspersons that pension reform will be a high priority agenda item. See Donna Rosato, Doors May Open to 401(k) Advice, N.Y. TIMES, Sept. 1, 2002 (citing Sen. Daschle as saying that pension reform will be second on the agenda behind homeland security).

80 H.R. 3762, 107th Cong. (2002) (enacted) (the stated purpose of the act is to "give workers new freedom to diversify their investments, much greater access to quality investment advice, advance notice before black out periods, more information about their pensions, and other tools they can use to maximize the potential of their 401(k) plans and ensure a secure retirement future").

81 S. 1992, 107th Cong. (2002) (permitting employer to contribute either company stock to 401(k) or offer company stock as investment alternative, but not both; giving employees access to independent non-conflicted investment advisors;
action by the Senate. Even if it passes, there are significant enough differences between the two bills such that compromise will not be easily reached. As one pension rights advocate observed, "Congress in general has been long on rhetoric and short on action" when it comes to pension reform. Absent some evidence of a greater willingness by Congress to act, the problems discussed herein will only worsen with time.

allowing employee to hold employer accountable if employee loses savings due to employer mismanagement; requiring employers to inform workers when executives sale stock; adds worker representation to boards of pension plans).


83 Pamela Yip, Pension Reform: Held Captive?, DALLAS MORNING NEWS, Aug. 19, 2002, at 1D (quoting Karen Friedman of Pension Rights Center). Another commentator has suggested it is now "a crapshoot" of whether or not pension reform will happen. Id.