An Agency Costs Theory of Employee Benefit Plan Law

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Courts have long tried to force employee benefit plan relationships into the pigeonholes of donative trust law. Scholars have bemoaned the results. In Thole v. U.S. Bank*, the Supreme Court recently perverted bedrock fiduciary principles when it held that pension plan participants did not have standing to bring fiduciary claims alleging violations of prudence and loyalty associated with self-dealing and the loss of almost $750 million in plan assets.*

It is past time to bring a new lens to bear on the challenges of building plan governance mechanisms that will enable U.S. workers to accumulate the financial resources they need for a secure retirement and decrease the social safety net costs of supporting superannuated individuals. This Article breaks new ground by building an agency costs model to conceptualize the relationship between benefit plan sponsors and plan participants. The model enables normative insights on how governance mechanisms may mitigate agency costs. It also illuminates how these normative insights can be used to improve positive law.

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INTRODUCTION

Participants in U.S. Bank's pension plan thought federal law prohibited plan fiduciaries from causing the plan to assume excessive risk and making investment decisions that benefited the fiduciaries. Participants also thought that the relevant federal law, the Employee Retirement Income Security Act of 1974 (ERISA),[1] explicitly provided them with a cause of action for fiduciary breach when, in their view, U.S. Bank's breaches of loyalty and care caused the plan to lose more than $748 million in the Great Recession of 2007-08.[2] After all, that law states: "A civil action may be brought . . . by a participant . . . for appropriate relief [for breach of fiduciary duty]."[3] However, in *Thole v. U.S. Bank*, the Supreme Court held that participants in U.S. Bank's pension plan did not have Article III standing to pursue their claims.[4] The Court's decision has left pension participants without direct legal recourse when employers egregiously breach their fiduciary obligations even when those breaches cause hundreds of millions of dollars in lost assets. The decision is the most recent in a line of decisions in which scholars have observed that the Court has undermined the scope and intensity of the fiduciary obligations owed to plan participants.[5]

1. Employee Retirement Income Security Act (ERISA), 29 U.S.C. §§ 1001–1461 (2018).
2. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1624 (2020) (Sotomayor, J., dissenting).
3. ERISA § 502(a), 29 U.S.C. § 1132(a).
4. 140 S. Ct. at 1618–19. The *Thole* decision is discussed in detail in Part IV.B.
5. *See infra* text accompanying notes 27–28.

Employee benefits law desperately needs a new approach to address the embedded conflicts of interest that are inherent in the employer-sponsored plan regime. The issues discussed in this Article have enormous social and economic significance. Private-sector retirement benefit plans hold $12.2 trillion in assets on behalf of employees.[6] States, which are beginning to mandate that workers have the ability to contribute to retirement savings accounts, vary in their approaches to fiduciary regulation.[7] Concerns over how long the Social Security program will continue to pay significant benefits for many Americans[8] reinforce the importance of private sector benefit plan assets to Americans' retirement security. The problem involving U.S. Bank's pension plan, however, illustrates that current pension plan governance structures are not up to the task of mitigating the conflicts of interest between the employers that sponsor benefit plans (plan sponsors) and the employees (participants) who rely on those plans for their retirement security.[9]

This Article shows that agency costs analysis provides a lens for courts and policymakers to develop a more nuanced understanding of the conflicts of interest in benefit plans.[10] Agency costs result from the lack of alignment in the interests of those in a principal-agent relationship.[11] For example, in Michael Jensen and William Meckling's classic paper *Theory of the Firm*, they discuss the agency costs that result when shareholders (the principals) rely on directors and managers (the agents) to run an organization.[12] Jensen

6. All asset amounts are approximate, as of December 31, 2021, and are from the Investment Company Institute's fourth quarter report. PRESS RELEASE, INVESTMENT COMPANY INSTITUTE, RETIREMENT ASSETS TOTAL $39.4 TRILLION IN FOURTH QUARTER 2021 (Mar. 28, 2022), https://www.ici.org/statistical-report/ret_21_q4 [https://perma.cc/2RTF-USJ3]. In addition, $2.6 trillion is held in annuity reserves. *Id.* This Article's analysis applies only to plans sponsored by private-sector employers because different regulatory regimes apply to public-sector plans and individual retirement accounts.

7. *See generally* Natalya Shnitser, *The New Fiduciaries*, 88 U. CIN. L. REV. 685 (2020) (discussing initiatives in five states to provide private sector workers with retirement savings opportunities).

8. *See generally* Jonathan Barry Forman, *Fully Funded Pensions*, 103 MARQ. L. REV. 1205 (2020) (discussing the roles of Social Security and private sector pensions and advocating for full funding of Social Security).

9. Participants are employees or former employees who are earning or have earned benefits in an employee benefit plan. ERISA § 3(7), 29 U.S.C. § 1002(7) (2018). Beneficiaries are individuals who have some entitlement to plan benefits because of their relationship with a participant. ERISA § 3(8), 29 U.S.C. § 1002(8). For purposes of simplification, this Article does not distinguish between participants and beneficiaries.

10. In his seminal article on applying agency costs to trust law, Robert Sitkoff suggested a similar approach could be useful for employee benefits law. Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 681 (2004).

11. *See* Lee-ford Tritt, *The Limitations of an Economic Agency Cost Theory of Trust Law*, 32 CARDOZO L. REV. 2579, 2584 (2011).

12. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976).

and Meckling identified three types of agency costs that arise in such organizations: (1) monitoring costs, (2) bonding costs, and (3) residual loss.[13]

The Supreme Court has heavily relied on donative trust law to apply ERISA's fiduciary provisions to benefit plans, but scholars have long observed that those legal principles do not translate directly to the benefit plan context.[14] The primary actors in trusts are settlors, trustees, and beneficiaries, not plan sponsors and participants.[15] Although courts often analogize benefit plan sponsors and participants to the trust law actors, the roles do not map neatly from one legal paradigm to the other.[16] The transition of retirement plans from defined benefit pension (DB) plans to defined contribution (DC) plans such as 401(k) plans has further increased the disconnect between the functions of donative trust actors and employee benefit plan actors.[17] Although trust law concepts are important to analyzing the governance of employee benefit plans, courts' overreliance on parallels between donative trust actors and benefit plan actors has resulted in excessive deference to employers' decisions.[18]

More fundamentally, the trust law and employee benefits law regimes differ in their foundational goals. Trust law's basic function is to facilitate donative transfers.[19] In their early days, trusts were used to transfer land within a family but now are used more often to facilitate the transfer of financial assets.[20] In contrast, employee benefits law is intended to protect employees' interests in their benefit plans.[21] By doing so, benefit law relieves pressure on the social safety net's need to care for aging Americans and prevents the transfer of tax expenditures intended to promote retirement security to employers and financial services firms.[22]

Despite the lack of alignment between the goals of trust law and employee benefits law, courts and policymakers continue to rely heavily on donative trust analogies. This is particularly problematic when they evaluate the conflicts of interest that inhere in benefit plans and determine the extent

13. *Id. See also infra* text accompanying notes 100–105.

14. *See, e.g.*, Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 35 U. CHI. L. REV. 1105, 1117 (1988).

15. *See* discussion *infra* Part II.

16. *See* Natalya Shnitser, *Trusts No More: Rethinking the Regulation of Retirement Savings in the United States*, 2016 B.Y.U. L. REV. 629, 654–58 (2016).

17. *Id.* at 632–35.

18. *See id.* at 665–66.

19. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 632–43 (1995).

20. *Id.* at 637–43.

21. ERISA § 2(b), 29 U.S.C. § 1001(b) (2018).

22. *Id.* § 2(a), 29 U.S.C. § 1001(a); Jonathan Barry Forman, *The Tax Treatment of Public and Private Pension Plans Around the World*, 14 AM. J. TAX POL'Y 299, 310–11 (1997) (explaining the tax incentives for retirement savings).

and intensity of fiduciary obligation.[23] As one pair of scholars recognized: "[W]hether inter-doctrinal or cross border, transplants can cause mischief. When a legal concept is taken from one context and incorporated into a fundamentally different setting, it may carry with it implications and characteristics that do not serve anyone's interests."[24] In transplanting trust law principles to benefits law without adapting them for the changed environment, courts have lost sight of the nature of principal-agent relationships.[25]

Agency costs, however, threaten the security of the more than $12 trillion held by benefit plans.[26] For example, a co-author and I explained that the court-made doctrine, which applies trust law concepts to label employers as both settlors and fiduciaries and then attempts to determine when each label applies, lacks nuance and prevents many plan decisions from being subject to ERISA's fiduciary constraints.[27] Professor Peter Wiedenbeck has shown that even where fiduciary duties exist, severe court-created limitations on the intensity of the duties undermine participant protection.[28]

This Article develops a basic model of agency costs for employee benefits law. It tests this model by applying it to issues that result from the conflicts of interest associated with plan investments.[29] As a preliminary but critical matter, Part I provides a brief history of the changing theoretical understanding of benefit plan entitlement. It next explains how the basic employee benefit plan paradigms have shifted over time. Part I ends with a review of the literature analyzing the divergence in the functions of actors in donative trusts and the functions of employers and participants in employee benefit plans. Part II engages the scholarship on the economic costs of agency and its application to donative trusts. The extent to which agency costs analysis provides normative and positive insights for the fiduciary duties imposed by trust law is of particular salience for the development of the employee benefits plan model. This Article does not contend that trust law principles are inapplicable to employee benefits law. Instead, it argues that an agency costs analysis can enable courts to apply principles derived from trust law in a more nuanced way than they have done in the past. Part II considers the limited prior literature on agency costs in the employee benefit

23. *See* Shnitser, *supra* note 16, at 654–58.

24. Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 652 (2002).

25. *See* discussion *infra* Part IV.

26. INVESTMENT COMPANY INSTITUTE, *supra* note 6.

27. Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. REV. 459, 536 (2015) ("The settlor/fiduciary doctrine operates mechanically and largely lacks nuance.").

28. Peter J. Wiedenbeck, *Untrustworthy: ERISA's Eroded Fiduciary Law*, 59 WM. & MARY L. REV. 1007, 1070–88 (2018).

29. *See infra* Part IV.

plan context. Part III develops an agency costs model for employee benefit plan law. Finally, Part IV applies the model to two types of situations related to the investment of plan assets where there is substantial risk of agency costs.

I. DISCONNECTS BETWEEN THE STRUCTURE OF DONATIVE TRUSTS AND EMPLOYEE BENEFIT PLANS

A brief introduction to the development of benefit plan regulation and the evolution of theories of benefits entitlement is useful to distinguish the nature of agency relationships in donative trusts from those in employee benefit plans. This Part begins by explaining the history of benefit plan regulation and how the theoretical nature of benefits entitlement has changed. The Part then considers common types of benefit plans. Finally, this Part concludes by discussing the literature on the divergence between the functions of donative trust actors and those of employee benefit plan actors.

A. Employee Benefit Plans: From Gratuities to Deferred Compensation

At least as early as 1901, courts began characterizing employer pension plans as gratuities given to employees for long service.[30] In what came to be known as the gratuity theory of pensions, employers offered the possibility of receiving pension benefits as a gift for long service, but—as is true of all gifts—the employers were not under any legal obligation to actually pay the benefits.[31] Employers reinforced the gratuity theory by including provisions in their pension plans and describing pension benefits as gifts. Although those provisions were sometimes called "weasel clauses," courts tended to enforce them as being part of the understanding between the workers and the employer.[32]

Employers did not have any obligation to pre-fund benefits that they characterized as gifts. Even if plans were pre-funded, though, the gratuity theory meant that employers were able to divert the assets to other uses.[33] At times, employers mismanaged or embezzled plan assets. If an employer went bankrupt, benefits would be forfeited unless they were funded, contractually promised rather than characterized as a gift, and the plan assets were shielded from creditors.[34] The combination of the gratuity theory and the lack of

30. *See* Patricia E. Dilley, *The Evolution of Entitlement: Retirement Income and the Problem of Integrating Private Pensions and Social Security*, 30 Loy. L.A. L. Rev. 1063, 1114 (1997).

31. *See* Kathryn L. Moore, *An Overview of the U.S. Retirement Income Security System and the Principles and Values It Reflects*, 33 Comp. Lab. L. & Pol'y J. 5, 25 (2011).

32. Muir & Stein, *supra* note 27, at 468.

33. *See* Jay Conison, *Suits for Benefits Under ERISA*, 54 U. Pitt. L. Rev. 1, 36 (1992) ("Many courts went so far as to treat a plan as employer property with which the employer could do as it pleased.").

34. *See* Staff of S. Comm. on Aging, 98th Cong., INFORMATION PAPER ON THE EMPLOYMENT RETIREMENT INCOME SECURITY ACT OF 1974: THE FIRST DECADE 2 (Comm. Print 1984) (prepared by

required, protected pre-funding meant that most workers did not receive pension benefits even when their employer had a pension plan. One scholar estimated that prior to ERISA, employers denied benefits to more than 90 percent of plan participants.[35]

Beginning in the 1920s, courts' conception of pensions started to change. Courts began to characterize some pension promises as contracts between an employer and its workers.[36] The transition may have been related to tax legislation in the 1920s, which for the first time provided some plans with tax-exempt status and permitted employers to deduct the costs of those plans.[37] Presumably once they had taken a tax deduction for the benefits, employers began to recognize that they had some obligation to pay the benefits.[38]

B. The Increasing Importance of Defined Contribution and Welfare Benefit Plans

Professor Norman Stein has described ERISA as delivering "the *coup de grace* to the gratuity theory"[39] of pension plans.[40] The next Section explains the statutory requirements that eliminated any remaining doubt about whether pension plans are gratuities. Commentators now largely agree that vested benefits constitute deferred compensation.[41] The Supreme Court implicitly accepted that theory when it recognized that employees earn vested

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Michael S. Gordon) (noting the bankrupting of plans during the Great Depression) [hereinafter INFORMATION PAPER ON ERISA].

35. Moore, *supra* note 31, at 26.

36. *See* Dilley, *supra* note 30, at 1115; *see also* Norman Stein, *An Article of Faith: The Gratuity Theory of Pensions and Faux Church Plans*, A.B.A. EMP. BENEFIT COMMITTEE NEWS. (2014), https://www.americanbar.org/groups/labor_law/publications/ebc_news_archive/issue-summer-2014/page01/ [https://perma.cc/MG3A-MDSD] ("The gratuity theory . . . began to erode in the 1930s.").

37. *See* INFORMATION PAPER ON ERISA, *supra* note 34, at 2–3; *see also* Dilley, *supra* note 30, at 1115.

38. *See* Dilley, *supra* note 30, at 1143–44.

39. Stein, *supra* note 36.

40. Wiedenbeck has offered a more nuanced timeline for the transition from the gratuity theory to the compensation theory for private sector plans. He also has noted that only plans regulated by ERISA are prohibited by federal law from sponsoring unfunded retirement plans. Wiedenbeck, *supra* note 28, at 1048 n.175.

41. *See, e.g.*, Bradley R. Duncan, *Judicial Review of Fiduciary Claim Denials Under ERISA: An Alternative to the Arbitrary and Capricious Test,* 71 CORNELL L. REV. 986, 1003 n.86 (1986). The deferred compensation theory of pension plans and the potential of implied contracts has become important in determining the extent to which government entities can amend the plans they sponsor. *See* Amy B. Monahan, *Statutes as Contracts? The "California Rule" and Its Impact on Public Pension Reform*, 97 IOWA L. REV. 1029, 1044 (2012). ERISA does not regulate those plans, and issues with their regulation are beyond the scope of this Article. ERISA § 4(b)(1), 29 U.S.C. § 1003(b)(1) (2018).

benefits during their productive work life and defer receipt of those benefits until after they retire.[42]

To address the problems of asset mismanagement and theft that had occurred in the pre-ERISA period, Congress incorporated fiduciary obligations based on traditional trust law duties when it enacted ERISA in 1974.[43] ERISA also imposed specific restrictions on an employer's discretion, including the employer's decision to not pre-fund a plan for promised benefits.[44]

ERISA's fiduciary provisions impose four obligations on plan fiduciaries. First, fiduciaries must act for the exclusive purposes of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. This loyalty obligation is often referred to as the "exclusive benefit rule."[45] Second, the statute requires fiduciaries to act prudently, thus imposing a care obligation.[46] Third, fiduciaries must diversify investments to minimize the risk of large losses. This prudent investment obligation applies unless it is clearly prudent not to diversify investments, or in certain other limited circumstances.[47] Fourth, fiduciaries are required to administer the plan in accordance with the plan's terms to the extent the terms do not violate ERISA.[48] The fiduciary obligations cannot be waived and apply to all types of plans.[49]

The primary plan of most employees who participated in a retirement plan in the year following ERISA's enactment was a defined benefit (DB) plan.[50] Those plans calculate benefits according to a formula, often based on years of employment and salary.[51] A DB plan commits to paying lifetime retirement benefits in the form of an annuity.[52] ERISA's minimum standards require DB plans to: (1) ensure participants accrue benefits incrementally over time rather than all at once only after many years of service, (2) set minimum vesting periods for those accruals so participants do not forfeit their benefits even after long periods of work, and (3) have advance funding rules

42. Lockheed Corp. v. Spink, 517 U.S. 882, 894 (1996) (stating that in benefit plans, "employer[s] promise[] to pay increased benefits in exchange for the performance of some condition by the employee"); *see* Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1624 (2020) (Sotomayor, J., dissenting) ("[E]mployees . . . sacrifice wages today to secure their retirements tomorrow . . . .").

43. Shnitser, *supra* note 16, at 632.

44. *See infra* text accompanying notes 53–54 (explaining these ERISA provisions).

45. ERISA § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i).

46. *Id.* § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

47. *Id.* § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C).

48. *Id.* § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).

49. *Id.* § 410(a), 29 U.S.C. § 1110(a); *see infra* text accompanying notes 382–83 (discussing implications of ERISA's proscription of exculpatory provisions).

50. Moore, *supra* note 31, at 20.

51. *Id.*

52. Dana M. Muir, *Contemporary Social Policy Analysis and Employee Benefit Programs: Boomers, Benefits, and Bargains*, 54 WASH. & LEE L. REV. 1351, 1361–62 (1997).

to ensure that money is available to pay the vested accrued benefits.[53] The provisions work in concert to prevent employers from treating plan benefits as gratuities.[54]

The accrual standards are particularly important to understand the agency costs model developed in Part III.[55] Even though ERISA prohibits DB plans from requiring participants to work many years prior to accruing any benefits, it still permits substantial backloading. A typical DB plan calculates benefits based on years of service and salary so an individual's benefit increases as service and pay increase. The result, where participants earn most of their benefits close to retirement, is known as backloading. Professor Jonathan Forman estimated that, depending on a variety of factors, backloading can cause participants to accrue more than half their total benefits in the last five to ten years of employment.[56]

Many scholars have addressed the reasons why employees transitioned to sponsoring defined contribution (DC) plans instead of DB plans.[57] For purposes of this Article, it is sufficient to understand that during the 1980s and into the 1990s, the prevalence of DB plans declined, as DC plans became ubiquitous.[58] Unlike DB plans, which promise a benefit fixed by a formula and payable for life, DC plans are akin to tax-advantaged individual savings accounts organized by employers.[59] Seventy-nine percent of workers who participate in a DC plan, participate in what the Bureau of Labor Statistics (BLS) characterizes as a savings and thrift plan.[60] Under the BLS definitions, all savings and thrift plans are 401(k) plans, although not all 401(k) plans are savings and thrift plans.[61] This Article follows the standard convention and

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53. Muir & Stein, *supra* note 27, at 471.

54. For example, without the backloading rules a plan could vest an employee in a de minimis benefit until the very end of her career when she would earn the rest of her benefits. By doing so, the plan would avoid the intended purpose of the vesting rules.

55. *See infra* text accompanying notes 228–248.

56. Forman, *supra* note 8, at 1257.

57. *See, e.g.*, Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 929–36 (2013).

58. In 1983, only nine years after ERISA was enacted, the number of employees earning benefits in DC plans eclipsed the number earning DB plan benefits. By 1985, employers sponsored more DC than DB plans; in 1997, the assets of DC plans exceeded those of DB plans. DC plans now are deeply instantiated as the retirement plan of choice for private-sector employers. More than seven times as many employees earn DC benefits as earn DB benefits. U.S. DEP'T OF LABOR, EMP. BENEFITS SEC. ADMIN., PRIVATE PENSION PLAN BULLETIN HISTORICAL TABLES AND GRAPHS 1975–2019*,* 4–16 (2021), https://www.dol.gov/sites/default/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf [https://perma.cc/B3Y7-Q5XL] [Hereinafter HISTORICAL PENSION TABLES]. All statistics cited from this source refer to plans with 100 or more participants.

59. Moore, *supra* note 31, at 20.

60. BUREAU OF LABOR STATISTICS, RETIREMENT PLAN PROVISIONS FOR PRIVATE INDUSTRY WORKERS IN THE UNITED STATES*,* 2019*,* TABLE 19 (2019), https://www.bls.gov/ncs/ebs/detailedprovisions/2019/ownership/private/table19a.pdf [https://perma.cc/R9WM-GUM5]

61. BUREAU OF LABOR STATISTICS, BEYOND THE NUMBERS 4 (2015), https://www.bls.gov/opub/btn/volume-4/pdf/selected-characteristics-of-savings-and-thrift-plans-for-private-industry-workers.pdf

does not distinguish between types of 401(k) plans. The defining features of a 401(k) plan are that employees may elect whether to contribute to their plan accounts, employers may contribute to the accounts, and ultimately an employee's benefit entitlement is the sum of account contributions adjusted for investment gains and losses.

Only 4 percent of employees who participate in a DC plan are in Employee Stock Ownership Plans (ESOPs).[62] Those plans are important, though, for purposes of this Article because of the more extensive conflicts of interest that inhere in ESOPs.[63] ERISA requires ESOPs to invest primarily in the stock of the plan sponsor, whereas no such provision exists for standard 401(k) plans.[64] ESOPs often hold that stock in a suspense account. Over time, as employees earn plan contributions through their employment, the plan transfers stock from the suspense account to participant accounts.[65]

A KSOP is a hybrid of a 401(k) and an ESOP.[66] KSOPs permit employees to make contributions as they would in a 401(k) plan.[67] The plan may allow employees to invest their contributions in employer stock.[68] The employer will usually match the employee contributions according to some formula and the employer's contribution comprises of company stock.[69] For example, the employer may match the first dollar an employee contributes to

[https://perma.cc/3ZEC-4KJK]. BLS only treats those 401(k) plans where employees must make contributions to receive employer matching contributions as savings and thrift plans. In addition to savings and thrift plans, the BLS reports data on the following types of DC plans: deferred profit sharing (15 percent of employees; this includes some 401(k) plans), money purchase pension plans (16 percent of employees), and Employee Stock Ownership Plans (ESOPs) (4 percent of employees). BUREAU OF LABOR STATISTICS, *supra* note 60. For a brief discussion of money purchase and deferred profit-sharing plans, *see* Anne Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUS. L. REV. 153, 166 n.57 (2013).

62. BUREAU OF LABOR STATISTICS, *supra* note 60. Commentators have long debated the advantages and disadvantages of ESOPs. *See generally, e.g.*, Hunter C. Blum, Comment, *ESOP's Fables: Leveraged ESOPs and their Effect on Managerial Slack, Employee Risk and Motivation in the Public Corporation*, 31 U. RICH. L. REV. 1539 (1997) (discussing leveraged ESOPs); Ezra S. Field, Note, *Money for Nothing and Leverage for Free: The Politics and History of the Leveraged ESOP Tax Subsidy*, 97 COLUM. L. REV. 740 (1997) (discussing leveraged ESOPs).

63. *See infra* text accompanying notes 370–75 (discussing one claim of a conflict of interest in an ESOP).

64. ERISA § 407(d)(6)(A), 29 U.S.C. § 1107(d)(6)(A) (2018).

65. *See* Michael W. Melton, *Demythologizing ESOPs*, 45 TAX L. REV. 363, 364–65 (1990). Professor Melton's article describes the operation of a leveraged ESOP where the plan borrows money to purchase the stock held in the expense account. Most ESOPs begin as leveraged ESOPs. *See* Suzanne Guitar Odom, *Employee Stock Ownership Plans: Innovative and Tax-Efficient Tools to Meet Your Clients' Business Planning Needs*, 26 S.C. Law. 24, 26 (2014).

66. Norman P. Stein, Colleen E. Medill, Susan J. Stabile, Jeffrey N. Gordon, Louis H. Diamond, Damon Silvers & Patricia Dilley, *Employee Stock Ownership after Enron: Proceedings of the 2003 Annual Meeting, Association of American Law Schools Section on Employee Benefits*, 7 EMP. RTS. & EMP. POL'Y J. 213, 235 (2003) (remarks of Louis H. Diamond).

67. *Id.*

68. *Id.*

69. *Id.*

the plan by contributing a dollar of employer stock to the employee's account. The match will be capped as a maximum percentage of employee pay.[70] The employer may decrease its rate of match for higher levels of employee contributions.[71] When this Article refers to ESOPs, the analysis typically would be similar for KSOPs.

In comparison to DB plans, ERISA's prefunding requirements, accrual rules, and insurance program have little or no application to DC plans. An employer may sponsor a DC plan but not contribute to it. Barring any voluntarily assumed contractual obligation to contribute, an employer that does contribute may discontinue or change its contributions at any time in the future.[72] Many employers came to prefer the lower costs and greater flexibility of DC plans. However, ERISA's vesting and fiduciary rules apply to DC plans and those plans are also not mere gratuities.[73]

In addition to retirement plans, ERISA regulates what it designates as welfare benefit plans. Those plans include almost any kind of employee benefit other than those that defer compensation to termination of employment or retirement.[74] The most important welfare benefit plan types are health insurance and disability insurance plans.

Employers began to sponsor programs covering the cost of medical services in the 1920s.[75] By 1974, when ERISA was enacted, the costs of health insurance coverage had begun to increase, but still were not a significant issue for employers or employees.[76] In the words of one staff member involved in drafting ERISA, " [t]he answer as to why ERISA didn't do more respecting health and other welfare plans is quite simple: Unlike pension plans there was no crisis in health plans in 1974."[77]

Since 1974, health care costs have increased and the United States has struggled to reform its health care system. These problems became acute in

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70. *Id.* The cap on an employer's contribution may, for example, be five percent of employee pay. *Id.*

71. *Id.*

72. *See* Donald C. Carroll, *The National Pension Crisis: A Test in Law, Economics, and Morality*, 50 U.S.F. L. REV. 469, 491 (2016).

73. *See supra* text accompanying note 42.

74. *See* Brendan S. Maher, *Regulating Employment-Based Anything*, 100 MINN. L. REV. 1257 1269 n.36 (2016).

75. After John L. Lewis, the head of the United Mine Workers' (UMW) Union, was able to obtain jointly administered welfare and pension benefit plans for UMW members in the 1940s, other unions also began to push for welfare benefits. INFORMATION PAPER ON ERISA, *supra* note 34, at 4; *see also* John G. Day, *Managed Care and the Medical Profession: Old Issues and Old Tensions the Building Blocks of Tomorrow's Health Care Delivery and Financing System*, 3 CONN. INS. L.J. 1, 65–66 (1996) (attributing employers' adoption of health care plans to World War II-era price controls and tax policy in addition to union bargaining efforts).

76. Maher, *supra* note 74, at 1267–68.

77. Phyllis C. Borzi, *There's "Private" and Then There's "Private": ERISA, Its Impact, and Options for Reform*, 36 J.L. MED. & ETHICS 660, 661 (2008) (quoting Michael S. Gordon) (citation omitted).

the late 1990s when employers actively began to try to limit their health care expenditures.[78] Although ERISA's fiduciary, disclosure, and conflict resolution provisions apply to welfare benefit plans, the statute does not impose any funding, vesting, or other similar requirements on those plans.[79] Welfare benefit plans, such as health care plans, are significantly different from retirement plans. Accordingly, other than some discussion of the existing agency costs literature,[80] this Article defers to the future consideration of how an agency costs analysis may apply to the relationship between welfare benefit plan sponsors and participants and the regulation of those relationships.

C. *The Misfit Literature: Why Employee Benefit Plans Do Not Fit the Donative Trust Model*

Other scholars have noted the misfit between traditional donative trust law and employee benefit plans. In one of the earliest articles on the topic, Daniel Fischel and John Langbein observed in 1988—when DB plans remained popular—that employee benefit plans did not fit easily into the traditional donative trust law paradigm.[81] More recently, Natalya Shnitser extended the scholarship on the misfit between trust law and employee benefit plan law to the current benefits landscape where DC plans predominate.[82]

These scholars have argued that employers and participants each have characteristics of trust settlors and beneficiaries. For example, Fischel and Langbein noted that employers transfer contributions to benefit plans, which provides funding similar to a settlor's funding of a trust.[83] Fischel and Langbein argued that employers resemble trust beneficiaries because employers enjoy lower labor costs due to the tax benefits and decreased employee turnover.[84] Shnitser categorized participants as settlors because the participants choose to contribute to DC plans. Even in noncontributory DB plans the participants earn benefits as compensation for their work.[85] Fischel

78. Barry R. Furrow, *Health Reform and Ted Kennedy: The Art of Politics . . . and Persistence*, 14 N.Y.U. J. LEGIS. & PUB. POL'Y 445, 451 (2011).

79. *See* Maher, *supra* note 74, at 1270 (explaining ERISA regulates welfare benefit plans less than DB plans).

80. *See infra* text accompanying notes 151–160.

81. *See generally* Fischel & Langbein, *supra* note 14, at 1113 ("We suggest that these differences [between ordinary trusts and pensions trusts] undercut the rationale for routine application of trust law rules to employee benefit plans.").

82. Shnitser, *supra* note 16, at 632–33.

83. *See* Fischel & Langbein, *supra* note 14, at 1117.

84. *Id.* at 1117-19.

85. Shnitser, *supra* note 16, at 634.

and Langbein viewed participants as similar to trust beneficiaries to the extent that participants expect to receive plan benefits.[86]

By evaluating the roles of employers and participants through the lens of agency costs rather than looking only to trust law, this Article diverges from this prior scholarship. The agency costs approach provides a more nuanced understanding of the parallels between the roles of employee benefit plan actors and the roles of donative trust actors.[87] Because employers make plan contributions as compensation to employees, not as donative transfers,[88] the agency costs model developed below shows that employees, not employers, should be treated as plan settlors.[89] Further, because employers only receive lower labor costs in return for plan sponsorship—the costs of which constitute employee compensation—there is, at most, a weak parallel between employers and trust beneficiaries.

II. AN AGENCY COSTS ANALYSIS OF TRUST LAW

Although trust law's characterization of actors as settlors, trustees, and beneficiaries does not map neatly onto the relationships in employee benefit plans, and the two areas of law rest on different foundational goals, the application of agency costs theory to trust law provides a useful starting point for developing an agency costs model for employee benefits plans. Both trust law and ERISA rely on fiduciary principles to constrain self-interested behavior.[90] Trust fiduciary law remains the closest parallel to benefit plan law and this Article does not argue that courts should ignore trust law when interpreting ERISA's fiduciary obligations. Instead, this Article shows that agency costs theory can help develop a more nuanced fiduciary law for benefit plans by clarifying differences between the relationships in trusts and those in benefit plans. Thus, the agency costs model that Robert Sitkoff developed for trust law is an appropriate starting point for developing an agency costs model for employee benefits law. It is important to understand the trust law model in some detail, both because this Article uses it as a theoretical starting point and because it is useful in identifying how and why the trust law model needs to be adapted for the benefits context.

86. *See* Fischel & Langbein, *supra* note 14, at 1119.

87. *See infra* Part III.

88. *See supra* Part I.A.

89. *See infra* Part III.B.4–5.

90. *See* Robert H. Sitkoff, *An Economic Theory of Fiduciary Law, in* PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW 198, 199–200 (Andrew S. Gold & Paul B. Miller eds., 2014) (explaining the importance of fiduciary duties in constraining self-interest in trusts); Shnitser, *supra* note 16, at 632 (describing ERISA's fiduciary obligations as intending to constrain self-interested behavior by plan insiders).

This Part begins with a brief but necessary summary of the extensive literature on agency costs in the context of business organizations. It then explains Sitkoff's agency costs model for trust law.

A. The Economic Costs of Agency

The legal definition of agency requires both an agent to agree to act on a principal's behalf and under the principal's control, and a principal to agree to the relationship.[91] Deborah DeMott has explained that "agency relationships, as the law uses these terms, are best understood to enable one person (the 'principal') through an independent actor (the 'agent') to take legally-salient actions in relationship to third parties and facts about the world."[92] Agency enables brokers to buy and sell securities on behalf of clients, allows real estate agents to market and sell homes on behalf of homeowners, and facilitates a myriad of other transactions in which people engage specialists to work on their behalf and under their direction.[93]

Agency costs result from the lack of alignment between the interests of the principal and those of the agent.[94] Jensen and Meckling's classic paper outlined agency costs theory in the context of a business organization. The relationships between shareholders (the principals) and managers (the agents) meet the legal definition of agency because shareholders control managers, and both parties consent to the arrangement.[95] In the context of the business organization, agency costs theorists model these organizations as webs of contracts.[96] The contracts between shareholders and managers are necessarily incomplete because they must provide managers with sufficient flexibility to respond to markets and unpredictable events.[97] Further, shareholders may have neither the ability nor interest to closely monitor managers' actions.[98] Many of those actions are unobserved or unobservable.[99]

Jensen and Meckling identified three types of agency costs that arise in such organizations: (1) monitoring costs, (2) bonding costs, and (3) residual loss.[100] The costs result from the fundamental assumptions built into agency costs theory: that actors are rational and that they are utility maximizers.[101] Principals incur monitoring costs to limit actions agents might take that are

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91. RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. LAW INST. 2006).

92. Deborah A. DeMott, *The Contours and Composition of Agency Doctrine: Perspectives from History and Theory on Inherent Agency Power*, 2014 U. Ill. L. Rev. 1813, 1816 (2014).

93. Rock & Wachter, *supra* note 24*,* at 664.

94. Tritt, *supra* note 11, at 2584.

95. Jensen & Meckling, *supra* note 12, at 308–09.

96. Sitkoff, *supra* note 10, at 635.

97. *See* Tritt, *supra* note 11, at 2592–93.

98. *See* Sitkoff, *supra* note 10, at 636.

99. *Id.*

100. Jensen & Meckling, *supra* note 12, at 308.

101. Tritt, *supra* note 11, at 2590.

not in the principals' best interests.[102] Bonding costs assure principals that either the agent will act in the principals' best interests or that compensation will be available for departures from those interests.[103] If, in spite of the monitoring and bonding costs, an agent still fails to maximize the principal's interests, the resulting costs are categorized as residual loss.[104] Jensen and Meckling recognized that all three categories of costs also occur in relationships that do not meet the legal definition of agency. They wrote that "agency costs arise in any situation involving cooperative effort . . . by two or more people even though there is no clear cut principal-agent relationship."[105]

Fiduciary principles provide a governance structure to address these fundamental agency problems.[106] In all agency settings, the fiduciary obligation must balance retaining the benefits of the relationship—the ability of the agent to act on behalf of the principal—with mitigating the costs of an agent's self-interested behavior and slacking.[107] Thus, the duty of loyalty targets the agent's natural inclination to act in their self-interest, not the principal's.[108] Meanwhile, the duty of care establishes standards intended to discourage the agent from slacking.[109]

B. Application of Agency Costs Theory to Trust Law

Sitkoff's application of agency costs theory to trust law remains the seminal work on the application of agency costs theory to donative trust law.[110] This Section discusses how agency in trust relationships differs from agency in Jensen and Meckling's pure agency model. It then explains how Sitkoff analyzed the relationships among the primary donative trust actors. Finally, this Section explains how self-interest and limited oversight results in agency costs in trusts.

102. Jensen & Meckling, *supra* note 12, at 308.

103. *Id.*

104. *Id.*

105. *Id.* at 309.

106. Sitkoff, *supra* note 90, at 199–200.

107. *See id.* at 200.

108. *Id.* at 201.

109. *See id.* at 202.

110. Sitkoff, *supra* note 10; *see also* Tritt, *supra* note 11, at 2582 (referring to Sitkoff's article as "seminal"). This is not to imply that there have not been critics of Sitkoff's model. Professor Lee-ford Tritt authored the most extensive criticism. *See* Tritt, *supra* note 11, at 2593–97.

1. *Agency Complications in Trust Relationships*

The relationships among the primary actors in donative trusts depart from the relationships in Jensen and Meckling's pure agency model.[111] For example, trustees of donative trusts are not agents of beneficiaries in the legal sense of a principal-agent relationship because beneficiaries do not bargain for, or give consent to, the trustee.[112] However, Sitkoff observed that the challenges in trust governance parallel the challenges observed in classic agency situations.[113] Firms and donative trusts both separate risk-bearing from asset management, which creates a misalignment between the interests of the actors.[114]And donative trusts have both contractarian and property characteristics.[115] The trusts serve as the nexus for the contractual relationships just as the firm serves that role in the agency analysis of the firm.[116]

2. *The Relationships Among the Primary Donative Trust Actors*

Sitkoff's description of the less than perfect fit between the legal definition of agency and the relationships among the primary donative trust actors parallels the observations of commentators who have identified the misfit between benefit plan actors and trust actors.[117] For trusts, the agency fit issue is that two sets of relationships contain elements of principal-agent relations and result in two separate sources of agency costs.[118] First, the relationship between a settlor and a trustee, which provides a trustee with powers to act, poses what Sitkoff called a "temporal agency problem" unique to trust law.[119] After the settlor establishes the trust, the settlor cannot monitor the trustee.[120] Second, the relationship between the beneficiary and the trustee poses traditional conflicts of interest risks due to the trustee's self-interest.[121] Further, the beneficiary does not have control over the trustee, who the beneficiary had no role in choosing.[122]

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111. Jensen and Meckling's classic model begins with a "pure agency relationship," where the principal (a stockholder) has given the agent (a manager) authority to act on the principal's behalf. *See* Jensen & Meckling, *supra* note 12, at 309.

112. Sitkoff, *supra* note 10, at 646–47.

113. *Id.* at 639–40.

114. *Id.* at 640.

115. *Id.* at 638–39.

116. *Id.* at 639.

117. *See supra* Part I.C.

118. Sitkoff, *supra* note 10, at 624.

119. *Id.* at 640.

120. *See id.* at 640 n.92.

121. *See id.* at 640.

122. *See id.* at 639.

The trustee takes its direction from the trust terms established by the settlor but is to act on behalf of the beneficiaries.[123] In this sense, the trustee is stuck in the middle between the settlor and the beneficiary. Sitkoff described an "office of the trustee" (OoT) as an entity that informally exists separate from a person or organization designated as trustee.[124] This concept permits the rights of the OoT's creditors to be distinguished from those of the trustee's creditors.[125]

Although he skirts the question a bit, Sitkoff appears to have treated the settlor as the "dominant principal."[126] Sitkoff argued that the trust should be interpreted in accordance with the initial intent of the settlor and trustee, giving deference to any constraints imposed by the settlor.[127] This approach is consistent with the foundational goal of trusts: facilitating a property-owner's desire to transfer property in a way that separates ownership and management, subject to any reasonable constraints the settlor wishes to impose.[128] Sitkoff posited that the ability of a settlor to bargain with the OoT over matters such as the trustee's compensation also supports a settlor-centric approach.[129]

In the agency costs model for trust law, beneficiaries hold a residual claim on trust assets.[130] A trust beneficiary's claims are limited by any applicable trust terms.[131] The OoT and any third parties that transact with the OoT hold contract-based rights that are superior to the beneficiaries' rights.[132]

3. How Self-Interest and Limited Oversight Gives Rise to Agency Costs in Trusts

The agency costs model for trust law recognizes two dynamics that can give rise to agency costs. First, OoTs may have a repeat-player advantage over settlors, enabling OoTs to negotiate for inappropriate constraints on their liability.[133] Those constraints could give rise to high agency costs borne

123. *Id.* at 640.

124. *Id.* at 641.

125. *Id.*

126. *See id.* at 644, 669. Sitkoff believed that the beneficiaries' residual claimant status may explain why trustees owe them fiduciary obligations even though, under his analysis, they are not the dominant principal in the trust. *Id.* at 669.

127. *See id.* at 644, 669.

128. *See supra* text accompanying notes 19–20.

129. Sitkoff, *supra* note 10, at 643–44. To decrease the contracting costs, the default governance standards should reflect the terms the settlor and OoT would have negotiated. *Id.* at 644.

130. *Id.* at 646–47.

131. *Id.*

132. *Id.* at 646.

133. *Id.* at 644–45.

by the beneficiaries.[134] The second dynamic is a lack of robust price signaling in the market for OoTs.[135]

The repeat-player advantage and the absence of a transparent market could enable OoTs, which are superior claimants and have considerable discretionary authority over trust assets, to generate significant agency costs.[136] The shift in the primary use of trusts as a mechanism to transfer real property to a device that facilitates management of financial assets for multiple generations has significantly increased the risk and rewards of the beneficiaries as residual claimants.[137] The multitude of investment and management possibilities for financial assets vastly exceed the potential management decisions for real property and may be less transparent. An OoT's disloyal actions or slacking could deplete the trust's assets. Or, a loyal and particularly adept and conscientious OoT could build financial wealth for beneficiaries.[138]

Trust law relies primarily on fiduciary principles to address these potential agency costs.[139] Most rules concerning a trust's internal governance are default rules that a settlor can change when establishing the trust's terms.[140] However, trust law establishes a "mandatory foundation of trust governance law" by requiring an OoT to accept at least a minimum level of fiduciary obligation.[141] For example, the Uniform Trust Act limits the enforcement of some fiduciary exculpation provisions.[142]

The mandatory nature of the fiduciary governance regime mitigates agency costs associated with trustee discretion.[143] Otherwise, a naïve or overly trusting settlor might, as Sitkoff described, "swamp her beneficiary in an agency costs morass."[144] The mandatory governance provisions also reduce informational agency costs for third parties.[145] Those third parties are able to enter into transactions knowing that the trust is not a mere chimera and the property held by the OoT will remain distinguishable from the trustee's assets.[146]

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134. *See id.* at 645 n.15.

135. *Id.* at 645.

136. *See id.* at 646–47.

137. *Id.* at 647.

138. *See id.*

139. *Id.* at 642–43.

140. *Id.* at 642.

141. *Id.* at 642–43; *see* Reid Kress Weisbord, *Fiduciary Authority and Liability in Probate Estates: An Empirical Analysis*, 53 U.C. DAVIS L. REV. 2561, 2581–82 (2020) (discussing trust law's mandatory fiduciary rules).

142. Weisbord, *supra* note 141, at 2581–82.

143. Sitkoff, *supra* note 10, at 642–43.

144. *Id.* at 643; *see also* Weisbord, *supra* note 141, at 2582 (identifying the duties of loyalty and care as the "last line of defense").

145. Sitkoff, *supra* note 10, at 643.

146. *Id*.

In sum, Sitkoff built a basic model of agency costs in trust law that considers the relationships among settlors, OoTs, and beneficiaries. Although the model relies on the agency costs analysis applied in the context of business organizations, there are at least two important differences between the relationships in trusts and those in organizations. First, agency analysis in organizations rests on the concept of a nexus of contracts.[147] Because the rights of trust beneficiaries derive from a gift, beneficiaries do not have a contractual relationship with either the settlor or the OoT.[148] Second, the relationships among settlors, trustees, and beneficiaries do not parallel the agency relationship of shareholders and managers in business organizations.[149] The relationships between the settlor and the trustee on the one hand, and beneficiaries and the trustee on the other, both contain elements of economic agency, but those trust actors are not party to a legal principal-agent relationship.[150]

III. AGENCY COSTS IN EMPLOYEE BENEFIT PLANS

Surprisingly little scholarship has analyzed the potential application of agency costs theory to employee benefit plan law. This Part first examines the limited commentary. It then outlines an agency costs model for employee benefit plan law.

A. Literature on Agency Costs in Employee Benefit Plans

Much of the scholarship applying agency costs to employee benefit plans concentrates on health care benefits. Although this Article builds an agency costs model for retirement plans, the work on agency costs in health care plans provides some insight into the retirement plans model. This Section begins with a brief review of the scholarship on agency costs in health care plans and then discusses the limited scholarship related to agency costs in retirement plans.

In an early article exploring agency costs implications for benefit plans, Professor Dayna Bowen Matthew theorized the relationship between employers and employees in health care plans as "reverse agency."[151] Typically in the employment relationship, employees act as agents for their employers.[152] Matthew argued that the agency relationship in health care

147. *See* Jensen & Meckling, *supra* note 12, at 310–11.

148. *See* Tritt, *supra* note 11, at 2615–16.

149. *Id.* at 2603–06.

150. *Id.*

151. Dayna Bowen Matthew, *Controlling the Reverse Agency Costs of Employment-Based Health Insurance: Of Markets, Courts, and a Regulatory Quagmire*, 31 WAKE FOREST L. REV. 1037, 1039 (1996).

152. *Id.* at 1038–39.

plans is reversed because, when establishing and operating those plans, employers act as their employees' agent.[153] As in any other agency situation, the self-interest of the agent may give rise to agency costs. Employers, as agents, have a self-interest in minimizing their costs of sponsoring health care plans.[154] That interest may conflict with the participants' interests in having robust benefit coverage.[155]

As health care plans became more costly, and calls for reform became stronger, other authors built on Matthew's early analysis. John Bronsteen and his coauthors used an agency costs approach to evaluate the health care reform movements that existed as of 2008.[156] They evaluated the agency costs in employee benefit plans, including retirement plans, in terms of whether the costs presented a risk to participants' benefit expectations or a risk to plan assets.[157] Bronsteen and his coauthors were particularly concerned with zero-sum agency risk, which they identified as occurring when a dollar in benefits paid constitutes a dollar cost to the employer.[158] In such situations, the employer has a strong financial incentive to avoid paying the benefits. When a plan sponsor, or an agent working on the sponsor's behalf, has discretion in determining whether a participant is entitled to benefits or the amount of the entitlement, the zero-sum agency risk is high.[159] Those situations tend to occur in health care plans where certain types of coverage determinations are highly individualized due to the particularly incomplete nature of health care plans.[160]

Other scholars have used agency cost concepts to compare the structure of employee benefit plans to the relationships in corporate and trust law.[161] Sitkoff observed that one distinction between corporate law and trust law is that donative trusts tend to have relatively few residual claimants (trust beneficiaries) whereas corporations frequently have large numbers of

153. *Id.* at 1039.

154. *Id.* at 1038.

155. *Id.*

156. John Bronsteen, Brendan S. Maher & Peter K. Stris, *ERISA, Agency Costs, and the Future of Health Care in the United States*, 76 FORDHAM L. REV. 2297, 2308–12 (2008). Like Sitkoff, Bronsteen and his co-authors used the economic, rather than legal, definition of agency. *Id.* at 2304 n.24; *see* Sitkoff, *supra* note 10.

157. Bronsteen et al., *supra* note 156, at 2308–12.

158. *Id.* at 2306–09.

159. *Id.* at 2308–09; *see also* Katherine T. Vukadin, *On Opioids and ERISA: The Urgent Case for a Federal Ban on Discretionary Clauses*, 53 U. RICH. L. REV. 687, 688, 702–03 (2019) (discussing the role of discretion in denying coverage for opioid addiction treatment).

160. *See* Bronsteen et al., *supra* note 156, at 2309*; see also* William M. Sage, *Managed Care's Crimea: Medical Necessity, Therapeutic Benefit, and the Goals of Administrative Process in Health Insurance*, 53 DUKE L.J. 597, 604 (2003) (opining that "ambiguity in the interpretation of medical necessity is inevitable").

161. *See, e.g.*, George S. Swan, *The Law and Economics of ERISA and Fiduciary Duty:* LaRue v. DeWolff, Boberg & Associates, Inc., 36 OHIO N.U. L. REV. 403, 442–44 (2010); David H. Webber, *The Use and Abuse of Labor's Capital,* 89 N.Y.U. L. REV. 2106, 2160–63 (2014).

shareholders.[162] Sitkoff and George Swan argued that this is one reason fiduciary law is more effective in addressing agency costs in trust law than it is in corporate law.[163] The smaller number of trust beneficiaries both cabins the collective action problem faced by large numbers of litigants and increases the likelihood that a beneficiary has a sufficient personal interest to monitor and challenge wrongful fiduciary actions.[164] In a corporation with large numbers of shareholders, the dynamics change. The collective action problems are more intense, and because most shareholders are only negligibly affected by a wrongful fiduciary action, they have little personal interest in monitoring or challenging fiduciary misbehavior.[165]

Sitkoff and Swan posited that because many employee benefit plans have large numbers of participants, the agency costs of monitoring and litigation are closer to the agency costs that arise in business organizations than in trusts.[166] Plan participants face collective action problems that reduce their individual incentives to monitor fiduciaries and litigate breaches.[167] As a result, Sitkoff suggested that fiduciary duties are not as effective in governing fiduciary behavior in benefit plans as they are in donative trusts.[168]

Sitkoff and David Webber identified a second difference between corporate shareholders and trust beneficiaries that carries implications for agency costs in employee benefit plans: a robust market for shareholders' interests constrains costly behavior by agents. Usually the interests of equity shareholders are freely tradeable and thick markets tend to exist for public shares.[169] In contrast, trust beneficiaries typically cannot alienate their interest in the trust.[170] On this factor, DB and DC plans are more similar to donative trusts than to corporations because ERISA has strong anti-alienation provisions.[171] The impediments to the alienation of plan benefits increase the

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162. Sitkoff, *supra* note 10, at 679–80; *see* Swan, *supra* note 161, at 442–43 (discussing Sitkoff's view on the relevance of the varying number of actors in trust, corporate, and employee benefits contexts).

163. Sitkoff, *supra* note 10, at 678–80; Swan, *supra* note 161, at 443.

164. Sitkoff, *supra* note 10, at 679. Sitkoff recognized that the litigation incentives of trust beneficiaries are not optimal. *Id.* at 679–80.

165. *Id.*

166. *Id.* at 681; Swan, *supra* note 161, at 443.

167. Sitkoff, *supra* note 10, at 679–81.

168. *See* Sitkoff, *supra* note 10, at 678–80 (discussing the corporate-trust comparison).

169. *See* Webber, *supra* note 161, at 2162.

170. Sitkoff, *supra* note 10, at 677; Webber, *supra* note 161, at 2162.

171. See ERISA § 206(d)(1), 29 U.S.C. § 1056(d)(1) (2018). DC plan participants may access their DC plan assets before retirement through a variety of means, including loans to themselves from their accounts, withdrawals from an account at a prior employer, hardship distributions or, under some circumstances, a transfer to an IRA. Dana M. Muir, *How Behavioral Science Ultimately Fails Retirement Savers: A Noble Experiment*, 56 AM. BUS. L.J. 707, 723 n.89 (2019). Significant tax penalties, however, are intended to discourage early withdrawals by individuals younger than fifty-nine-and-a-half. *Id.* at 723. The ability to access plan assets in these ways does not provide the same type of constraint on agent behavior as the ability to alienate an interest.

risk of agency costs and the need for governance measures to protect participants from predatory actions or other misbehavior by agents.[172]

B. *Development of an Agency Costs Model for Employee Benefits*

This Section sketches a basic agency costs model for employee benefits, focused on DB and DC retirement plans. As a preliminary matter, this Section establishes the basis for creating an agency costs model adapted from the agency costs model for trust law. This Section then identifies the agency roles in the employee-employer relationship.

1. *Basis for Creation of an Agency Costs Model for Employee Benefit Plan Law*

The economic agency elements that arise in the context of benefit plans enable the plan sponsor to make benefits available to all or some employees more efficiently and on better terms than the individual employees might be able to arrange.[173] The plan sponsor, however, has significant conflicts of interest with the employees.[174] The costs that result from actions taken to benefit the sponsor or from the sponsor's slacking pose a risk for the retirement security of participants. Those costs spill over to society as wasted tax preferences and increased costs in social support for retirees.[175] Agency costs analysis provides a useful analytic tool in this setting, just as it does in trust law and the law of firms, to evaluate appropriate governance methods.

One critic of Sitkoff's model, Lee-ford Tritt, was troubled that the relationships between the settlor and the trustee on the one hand, and beneficiaries and the trustee on the other, both contain elements of economic agency.[176] Tritt argued that because no single relationship met the definition of either legal or economic agency, a strong form of agency analysis should not be applied to donative trusts.[177] In contrast, two important characteristics of benefit plans enable the assumptions that underlie agency costs theory to fit more closely with benefit plans than with donative trusts. First, in the employee benefit plan analysis, as explained below, it is clearer than in trust relationships which party is the dominant principal and which the dominant

172. *See* Webber, *supra* note 161, at 2163 (noting the importance of increased protection for trust beneficiaries compared to corporate shareholders).

173. For example, in both DB and DC plans, larger pools of assets may enable access to institutional investment products that earn higher returns than noninstitutional products. Muir, *supra* note 171, at 746–49. Also, participants receive stronger regulatory protection and the ability to save more in employer-sponsored plans than they might in individual tax-favored retirement savings products such as Individual Retirement Accounts. *Id.* at 756–58.

174. *See infra* text accompanying notes 332–44 (discussing conflicts in DC plans).

175. *See* Matthew, *supra* note 151, at 1041; *see also supra* text accompanying note 22.

176. Tritt, *supra* note 11, at 2585.

177. *Id.*

agent.[178] Second, unlike donative trusts, which depart from the usual agency model by having three primary actors, employee benefit plans have two primary actors: the plan sponsor and the participants.

2. The Employee Benefit "Plan"

Although most assets of employee benefit plans are held in trust,[179] the nomenclature typically refers to an employer's provision of benefits as a plan rather than a trust.[180] The plan is the organizational entity that holds assets, has liabilities and responsibilities, and provides benefits.[181] All ERISA plans must have a written plan document that sets forth a variety of governance requirements.[182] The plan document is the benefit plan's corollary to a donative trust's trust document. ERISA requires benefit plan fiduciaries to act according to the plan's terms to the extent those terms are consistent with ERISA.[183] Unlike in donative trust law, none of ERISA's fiduciary duties may be waived by a plan's terms.[184]

3. The Dominant Agent

The agency model for employee benefits must address the question: Who is "the agent?" In the context of business organizations, there is a simple answer to that question. In firms, managers are the agents.[185] Those managers may hire agents to assist in the corporations' operations. Sitkoff's model treats the trustee as the dominant economic agent.[186] A trustee may hire agents to process investment transactions or other actions necessary to the trust's operation. Agency costs models generally concentrate on the managers or trustees who are the dominant agents. Those agents possess the discretionary authority that gives rise to agency costs and are responsible for any agency costs they directly or indirectly generate.

Scholars have considered who fills the role of agent in benefit plans. Matthew treated plan sponsors as agents in her analysis of agency costs in benefit plans.[187] Bronsteen and his coauthors made the more general

178. *See* discussion *infra* Part III.B.3–5.

179. *See* ERISA § 403, U.S.C. § 1103 (2018).

180. *See, e.g.*, Tibble v. Edison Int'l, 575 U.S. 523, 525 (2015) (referring to "the Edison 401(k) Savings Plan (Plan)").

181. *Id.* (referring to losses allegedly suffered by the "Plan").

182. Muir & Stein, *supra* note 27, at 527.

183. ERISA § 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D).

184. *See id.* § 410(a), 29 U.S.C. § 1110(a) ("[A]ny provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy.").

185. *See* Jensen & Meckling, *supra* note 12, at 309.

186. Sitkoff, *supra* note 10, at 624.

187. Matthew, *supra* note 151, at 1038–39 (referring to plan sponsors as employers in the agent role for benefit plan selection).

contention that: "[T]he principal (i.e., the plan participant) relies on the agent (i.e., the plan fiduciary) to protect and advance the principal's interest."[188]

The agency costs model developed in this Article also treats plan sponsors as dominant agents. Plan sponsors receive the authority to act as the dominant agent for benefit plans via two routes. First, ERISA requires that every plan specify a "named fiduciary."[189] Typically that is the plan sponsor or an employee or committee of employees designated by the plan sponsor.[190] Plan sponsors also typically become plan fiduciaries through ERISA's "functional fiduciary" route.[191] Loosely stated, ERISA provides that anyone with discretion over plan assets, administration, or management, or who provides investment advice on plan assets, is a fiduciary to the extent that they exercise or have authority over those functions.[192] Even if plan sponsors name a committee or an outsider as the named fiduciary, many of the plan's fiduciary decisions are made by employees of the plan sponsor, causing the plan sponsor to be a fiduciary.

The allocation of agent status and fiduciary obligation to plan sponsors is consistent with the use of fiduciary duty as a governance mechanism to combat agency costs. The plan sponsor not only exercises discretion in its plan-related decisions, it also exercises discretion in appointing other agents for the plan. That discretion may give rise to self-interested decisions or slacking.[193]

In short, the buck in employee benefit plans stops with the plan sponsor.[194] For purposes of clarity, the agency model developed here treats employers that sponsor plans as "dominant agents" when they act on behalf of participants. The terminology recognizes that the responsibility of plan sponsors is broader in scope vis-à-vis their plans than the responsibility of other plan agents.

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188. Bronsteen et al., *supra* note 156, at 2304.

189. ERISA § 402(a)(1), 29 U.S.C. § 1102(a)(1) (2018).

190. *See* Maher, *supra* note 74, at 1279 n.73 ("A plan sponsor—the employer—is originally the "named fiduciary" of the plan unless it designates someone else."). *But see* Colleen Medill, *Regulating ERISA Fiduciary Outsourcing*, 102 IOWA L. REV. 505, 509 (2017) (explaining that third parties market plan structures in a manner that designate those third parties as the named fiduciaries).

191. Dana M. Muir, *From Schism to Prism: Equitable Relief in Employee Benefit Plans*, 55 AM. BUS. L.J. 599, 618 (2018).

192. ERISA § 2(21), 29 U.S.C. § 1002(21)(A). The exact statutory language is: "[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee . . . with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan." *Id.*

193. Examples of self-interested behavior and slacking are discussed in Part IV, *infra*, in the application of the agency costs model to employee benefit plans.

194. *See* Dana M. Muir, *Revenue Sharing in 401(k) Plans: Employers as Monitors?*, 20 CONN. INS. L.J. 485, 504 (2014).

4. Employers Are Not the Functional Equivalent of Donative Trust Settlors

As explained above, Fischel and Langbein and Shnitser argued that plan sponsors do not fit neatly within the donative trust definition of either beneficiary or settlor.[195] They contended that plan sponsors' interactions with the plan are similar to both those of beneficiaries and settlors.[196] Employers resemble trust settlors, though, only in that employers decide whether to establish and sponsor a benefit plan; the resemblance ends there.

Sitkoff relied on "the settlor's intent to create a trust" as the "trigger" for the relationships at the heart of which is the trust.[197] The trust model appears to assume that the trust is not just created by the settlor but also that the settlor funds the trust. It is difficult to imagine how agency costs could occur in the absence of trust assets.[198] Sitkoff's settlor-centric approach also is consistent with the motivating goal of trust law—to facilitate the settlor's transfer of assets.

DC and DB plans part ways with donative trusts when it comes to how those plans are funded relative to how trusts are funded. Settlors of donative trusts gratuitously fund those trusts. In contrast, under the compensation theory of employee benefits,[199] benefits are funded as compensation for work and not as gratuities. If an employer established a benefits plan but no employee ever earned benefits, the plan sponsor would have no obligation to transfer assets to the plan and no employee would have any rights to plan assets. Any trust would be an empty shell, the plan document would not govern any assets, liabilities, or rights, and there could be no agency costs.

It is understandable why prior commentators have drawn parallels between the actions of plan sponsors and those of trust settlors. If ERISA's fiduciary duties are modeled on those of trust law, then it is natural to try to analogize the parties in fiduciary legal actions to the actors in trusts. The agency model for benefit plans, however, shifts the focus away from the search for weak analogies with trust actors. Instead, agency costs theory examines economic agency relationships in benefit plans. The question, therefore, becomes: In plan relationships, do the plan sponsors act as the

195. *See supra* Part I.C.

196. *Id.*

197. Sitkoff, *supra* note 10, at 643–44.

198. *See id.* at 657–58 (referring to the settlor's ex ante preferences); *see also* N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 2213, 2217–18 (2019) ("[A] trust is created when one person (a 'settlor' or 'grantor') transfers property to a third party (a 'trustee') to administer for the benefit of another (a 'beneficiary').").

199. *See supra* Part I.A (explaining the compensation theory of employee benefits).

primary economic principal? The answer has to be no. The money that funds plans is participant money; it is compensation for an employee's labor.

Finally, even the most ardent believer in the concept that a single entity, such as a plan sponsor, can play multiple roles in benefit plans should have trouble conceptualizing a relationship where a single entity is both the dominant agent and dominant principal. For these reasons, the employee benefit model of agency costs refers to employers as plan sponsors, not as settlors. As plan sponsors, they are dominant agents, not dominant principals.

5. *The Dominant Principals in Benefit Plans*

If plan sponsors are not the dominant principals, who fills that role in benefit plans?[200] Prior scholarship has concentrated on a different question: How are participants similar to the beneficiaries and settlors in donative trusts? Reframing the issue to identify a dominant economic principal shifts the focus to the nature of the agency relationships and ultimately can help develop appropriate governance mechanisms to mitigate agency costs. The subsections below interrogate the funding of benefit plans, distinguish the identification of the dominant economic principal in benefit plans from the treatment of settlors in the trust law model, and consider who holds the residual interest in employee benefit plans.

a. *Participants Trade Their Labor for Benefit Plan Funding*

Unlike beneficiaries of donative trusts, benefit plan participants are not gratuitous transferees. The employer's creation of a benefit plan does not give rise to the relationships between a plan sponsor and participants. Instead, under the compensation theory of employee benefits plans, it is the participants' decision to earn plan benefits with their labor and directly or indirectly contribute assets to the trust, which creates the relationships. Without at least one employee's contribution of labor, no plan assets would be needed. Similarly, no relationship would exist between an employee and the plan sponsor of an empty plan.

In some ways, the employer's role in establishing the plan and trust parallels the role of the individual or entity who acts as a firm's incorporator. The incorporator authors and files the articles of incorporation and establishes the firm's bylaws. Those documents form the basis of the contracts that govern the relationship between management (the agent) and shareholders (the principal).[201] Filing the relevant documents, however, does

200. Identifying the dominant principal is not the same as identifying the party to whom a fiduciary owes its duties. The latter question is beyond the scope of this Article. For scholarly discussion of the party to whom a fiduciary owes its duties, see, for example Conison, *supra* note 33, at 10–11.

201. Megan Wischmeier Shaner, *Interpreting Organizational "Contracts" and the Private Ordering of Public Company Governance*, 60 WM. & MARY L. REV. 985, 1005–06 (2019); *see* Jensen & Meckling, *supra* note 12, at 311 (discussing the corporation as a nexus of contracts).

not make the incorporator a principal. Without some investment, the corporation would only be an empty shell. The same is true of an employee benefit plan. The plan's assets exist only because employees directly or indirectly earn benefits through their labor. Whether the employer or the employee make the contributions to the plan is irrelevant; it is employees who have put valuable assets at risk in reliance on the expertise of others. Thus, employees, not employers, are the economic principals in employee benefit plan relationships.

b. *Importance of Residual Claimant Status*

In the context of firms, the agency costs theory identifies the dominant principal by looking to who within the firm is a residual claimant. A residual claimant is the person or entity who is entitled to the remaining assets after all other claimants are paid.[202] The literature on firms treats equity shareholders as the residual claimants and, thus, dominant principals.[203] Among the parties that contract with the firm, only equity shareholders have a right to firm assets after all other claimants are paid according to their contractual rights.[204]

Residual claimant status determines the identity of the dominant principal because residual claimants incur the greatest risk due to agency costs. Jensen and Meckling observed that so long as the owner-manager is the sole owner of the firm, the owner will maximize his utility.[205] As the manager sells larger portions of the firm to outside shareholders, however, the manager's interests increasingly depart from the interests of the equity shareholders.[206] The shareholders then experience higher monitoring costs to prevent the manager from working in their own interest or slacking, thus reducing the shareholders' returns.[207] Debt holders and other fixed claimants get paid before equity shareholders so assume less risk than equity shareholders.

c. *Residual Claimant Status in Employee Benefit Plans—the Orthodoxy*

Orthodoxy has it that plan participants are the residual claimants in DC plans, but that plan sponsors are the residual claimants in DB plans. The logic is that residual claimant status in plans depends on who has the residual entitlement to plan assets. In any employee benefit plan, participants only are

202. Robert Anderson IV, *A Property Theory of Corporate Law*, 2020 COLUM. BUS. L. REV. 1, 18–19 (2020).

203. *Id.*

204. Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 913 (2010).

205. Jensen & Meckling, *supra* note 12, at 312.

206. *Id.* at 312–13.

207. *Id.*

entitled to the benefits promised by the plan terms. DC plans promise whatever assets are held in a participant's account.[208] Because DC plan participants bear the upside and downside risk in their accounts, they are residual claimants.

To the extent the literature has considered the question, scholars have generally claimed that plan sponsors are the residual claimants in DB plans. They have argued that plan sponsors hold the upside and downside risks associated with plan assets.[209] Employers must fund DB plans sufficiently that participants receive their accrued, vested benefits, as calculated by the plan's benefit formula.[210] ERISA's funding rules thus appear to place the funding risk in DB plans entirely on plan sponsors.[211] If the plan's investments perform poorly, plan sponsors must make higher contributions to ensure the plan meets its funding requirements. Therefore, the plan sponsor bears the downside risk. If the investments perform well, the plan sponsor may be able to make lower contributions. Thus, the plan sponsor would bear the upside risk.[212] Some scholars have argued that treating plan sponsors as the residual claimants in a DB plan properly incentivizes them because otherwise plan sponsors would be overly risk adverse in managing plan assets.[213]

d. Residual Claimant Status in Defined Benefit Plans – Challenging the Orthodoxy

It is misguided to characterize plan sponsors as the residual claimants, and thus dominant principals, in DB plans. In the context of firms, agency costs theory identifies residual costs and also considers what monitoring and bonding costs are incurred to reduce those residual costs.[214] As ownership (i.e., the principals) is separated from management (i.e., the agents), owners

208. Jeffrey N. Gordon, *Employees, Pensions, and the New Economic Order*, 97 COLUM. L. REV. 1519, 1539–40 (1997). A plan may hold assets outside the participant accounts, such as when employees forfeit unvested employer contributions in a 401(k) plan or an ESOP terminates prior to all stock being allocated to employees. However, as explained in the text in this Part regarding DB plans, the reversion of the assets to the employer is a matter of an administrative mismatch in plan assets and obligations.

209. *E.g.*, *id.*; *see also* Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1620 (2020) ("[T]he employer, not plan participants, receives any surplus left over after all of the benefits are paid; the employer, not plan participants, is on the hook for plan shortfalls."); David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 199 n.58 (2005) (arguing that taxpayers should be the residual claimants in government DB plans because they bear the risk of plan underfunding).

210. David I. Walker, *The Practice and Tax Consequences of Nonqualified Deferred Compensation*, 75 WASH. & LEE L. REV. 2065, 2096 (2018). The federal fisc bears some of the downside risk because plan contributions are tax deductible. *See* Forman, *supra* note 22, at 310–11 (describing tax deductibility of employer contributions).

211. *See* Walker, *supra* note 210, at 2096.

212. Gordon, *supra* note 208, at 1539–42.

213. *See, e.g.*, *id.* at 1542.

214. Jensen & Meckling, *supra* note 12, at 308.

run the risk that managers will appropriate wealth through self-interested transactions or slacking.[215] Therefore in the context of DB plans, it is critical to identify the extent to which the dominant agents—the plan sponsors—may impose residual costs on participants.

Those who adhere to the orthodoxy that plan sponsors are the residual claimants in DB plans ignore the regulatory provisions and potential plan sponsor actions that greatly diminish plan sponsors' actual upside and downside risks. DB plan sponsors have opportunities to shift downside risk to the Pension Benefit Guaranty Corporation (PBGC) or DB plan participants. Participants who lose expected benefits may look to the social safety net, which transfers risk to society. The orthodoxy also fails to recognize ERISA's paternalistic and social goals.[216]

Because of the importance of downside risk, the following subsection considers that risk. Then for the sake of completeness, it evaluates the assignment of upside risk in DB plans.

i. Downside Risk

Plan sponsors that desire to shift at least some downside risk of DB plans to participants may choose among multiple strategies. Regardless of the specific strategy, the plan sponsor reduces or eliminates its obligation to increase plan contributions to address current or future plan underfunding. The downside risk, however, does not disappear. Instead, it shifts to participants, who may lose benefits, or to the PBGC, taxpayers, and the social safety net. Risk-shifting strategies used by plan sponsors include terminating an underfunded plan or amending or converting a plan.

One approach a plan sponsor can use to shift downside risk away from itself is available if the sponsor is not able to meet its financial obligations to an underfunded plan. In that circumstance, the plan terminates and the PBGC takes over the plan's assets and liabilities.[217] Depending on the financial situation of the plan sponsor, it then may avoid all liability for the plan's underfunding.[218] The PBGC or participants, or some combination of the two, assume the resulting costs.

215. *Id.* at 312–13.

216. *See supra* text accompanying notes 21–22.

217. Muir & Stein, *supra* note 27, at 495 n.242; *see also* Margaret Blair, *The Great Pension Grab: Comments on Richard Ippolito, Bankruptcy and Workers: Risks, Compensation and Pension Contracts*, 82 WASH. U. L.Q. 1305, 1306–07 ("[W]hen the returns on the pension portfolio are low, the corporation can 'put' the pension assets to the Pension Benefit Guaranty Corporation . . . , forcing it, rather than the employer, to satisfy the employer's promised pension obligations.").

218. *See* Israel Goldowitz, Garth Wilson, Erin Kim & Kirsten Bender, *The PBGC Wins a Case Whenever the Debtor Keeps Its Pension Plan*, 16 MARQ. BENEFITS & SOC. WELFARE L. REV. 257, 273–76 (2015).

The PBGC guarantees participants' accrued, vested basic benefits up to a statutory cap.[219] A 2008 study showed that 84 percent of participants in the plans sponsored by an individual employer and taken over by the PBGC received their full benefits.[220] However, the losses experienced by the relatively small numbers of participants whose basic benefits are above the cap can be significant. Participants who do not receive their full basic benefits experience an average reduction of 28 percent.[221] Further, there is no guarantee for any benefits increased by plan amendments within the five years prior to the plan's termination.[222] Therefore, participants as a class hold some of the residual risk when underfunded plans terminate.

The PBGC is funded by its investment returns and insurance premiums paid by DB plans.[223] The premiums are set by statute and are only marginally risk adjusted.[224] To the extent the PBGC pays benefits that exceed the funding of the plans it assumes, the PBGC must cover the costs through the insurance premiums or gains on investment of the assets. Otherwise, the PBGC incurs a funding deficit. At the end of fiscal year 2020, the PBGC's largest insurance program had assets in excess of liabilities; however, in its annual performance and financial report, the PBGC noted that it remained exposed to $176 billion in underfunded DB plans.[225]

The PBGC is not formally backed by the federal fisc.[226] There is some likelihood, though, that if it became insolvent the federal government would provide financial support. In fact, in 2021, Congress enacted legislation to provide federal assistance to critically underfunded multiemployer plans.[227] The bottom line is that the PBGC, and ultimately taxpayers, hold some of the risk of underfunded, terminated plans.

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219. Blair, *supra* note 217, at 1306–07. In 2021, the statutory cap for straight life annuities at age sixty-five is $6,034.09 per month. PENSION BENEFIT GUAR. CORP., MAXIMUM MONTHLY GUARANTEE TABLES, https://www.pbgc.gov/wr/benefits/guaranteed-benefits/maximum-guarantee [https://perma.cc/5M4Y-59ZX].

220. JOHN J. TOPOLESKI & ELIZABETH A. MYERS, CONG. RESEARCH SERV., 95–118, PENSION BENEFIT GUARANTY CORPORATION (PBGC): A PRIMER 8 (2021), https://crsreports.congress.gov/product/pdf/RS/95-118 [https://perma.cc/R54T-VNZ2].

221. *Id.* More recent data do not appear to be available. Participants with benefits that exceed the PBGC cap may be officers and key employees who may be compensated in other ways for their loss of benefits.

222. Goldowitz et al., *supra* note 218, at 265 n.40.

223. *Id.* at 263.

224. *Id.*

225. PENSION BENEFIT GUAR. CORP., PBGC ANNUAL PERFORMANCE AND FINANCIAL REPORT 2020, https://www.pbgc.gov/about/annual-reports/pbgc-annual-performance-financial-report-2020 [https://perma.cc/E6FQ-VTGF].

226. Goldowitz et al., *supra* note 218, at 263.

227. Triston G. Axelrod & David A. Mawhinney, *First Glance: Legislative Update, The COVID-19 Stimulus Bill and Pension Liability: A Lifeline for Underfunded Multiemployer Pension Plans,* 40-5 AM. BANKR. INST. J. 8, 65–66 (2021).

Instead of terminating its DB plan, a plan sponsor may shift downside risk to participants by amending or converting its plan. For example, a plan sponsor may freeze a plan by continuing the plan but amending it to disallow participation by new employees (often referred to as a soft freeze) or to prevent all employees from accruing additional benefits (often referred to as a hard freeze).[228] Or, the plan sponsor may prospectively decrease the rate of benefit accrual.[229] As explained earlier, DB participants typically earn a substantial portion of their benefit entitlement in the final years of their employment.[230] The sponsor of any DB plan that wants to decrease its future contribution obligations may amend its plan in one of these ways, which may undermine the expectations of current employees.

A large number of Fortune 500 companies have shifted downside risk by freezing their DB plans. Between 1998 and 2017, the percentage of Fortune 500 companies that offered a DB plan to new employees dropped from 58 percent to 16 percent.[231] All but 2 percent of the decrease came from plan sponsors freezing their DB plans; and almost 60 percent of those freezes were hard freezes.[232] One study investigating these freezes showed that plan sponsors were more likely to freeze underfunded plans.[233] According to that study, higher levels of underfunding were associated with hard freezes rather than soft ones.[234] Those hard freezes enabled plan sponsors to enjoy immediate decreases in their plan funding requirements and improvements in their financial reporting.[235]

Authors of another study also estimated that plan sponsors accrue significant cost savings by freezing plans.[236] The research indicated that in a hard freeze, at least part of those savings constitute a transfer from older, longer-service employees.[237] The largest cost savings are attributable to the

228. Janice Kay McClendon, *The Death Knell of Traditional Defined Benefit Plans: Avoiding a Race to the 401(K) Bottom*, 80 TEMP. L. REV. 809, 816 (2007).

229. *See* Barry Kozak, *The Cash Balance Plan: An Integral Component of the Defined Benefit Plan Renaissance*, 37 J. MARSHALL L. REV. 753, 777 (2004) (observing that substantial decreases in future accruals may cause a partial plan termination).

230. *See supra* text accompanying note 56.

231. Joshua D. Rauh, Irina Stefanescu & Stephen P. Zeldes, *Cost Saving and the Freezing of Corporate Pension Plans*, 188 J. PUB. ECON. 1, 3 (2020). During the late 1980s and early 1990s, most decreases in benefit plan sponsorship were attributable to plan terminations. Alicia H. Munnell & Mauricio Soto, *Why Are Companies Freezing Their Pensions?,* CTR. FOR RET. RESEARCH AT BOS. COLL. at 3 (2007).

232. Rauh et al., *supra* note 231, at 4.

233. Munnell & Soto, *supra* note 231, at 21.

234. *Id.*

235. *Id.* at 15.

236. See Stephen F. Befort, *The Perfect Storm of Retirement Insecurity: Fixing the Three-Legged Stool of Social Security, Pensions, and Personal Savings*, 91 MINN. L. REV. 938, 949 (2007) (citing decreased volatility in funding obligations and one of the two primary motivations for plan conversions).

237. Rauh et al., *supra* note 231, at 17. Top executives of the firm, however, do not experience the same level of negative impact from pension freezes. Research shows that in the year prior to a pension

decrease in benefit entitlement of employees between ages fifty and sixty-five.[238] According to the authors, their findings "suggest[] that at least part of the cost savings [enjoyed by plan sponsors] is arising from reneging on implicit contracts for seasoned workers."[239] Although plan sponsors tend to increase their contributions to 401(k) plans when they hard freeze DB plans, even workers between the ages of twenty and thirty-four typically experience some decrease in the value of their retirement benefits as a result.[240]

Some plan sponsors use a more creative way to shift risk while making it difficult for participants to understand the potentially negative effect of plan changes on their future benefit entitlements. This technique involves the conversion of a traditional DB plan into a cash balance plan. This type of conversion typically decreases the volatility and unpredictability of the plan sponsor's contributions and reduces employees' future benefits.[241]

Plan sponsors that convert traditional DB plans to cash balance plans may enjoy transfers in wealth from their older, longer-service employees, similar to the wealth transfers that result from plan freezes. Although technically categorized and regulated as DB plans, the benefits provided by cash balance plans bear a closer resemblance to those provided by DC plans.[242] Each participant has a notional account, and the plan sponsor contributes a percentage of the employee's salary and an additional amount to provide an investment return.[243] Typically, the calculation of the investment return is based on a widely used interest rate.[244] The nature of the benefits formula enables plan sponsors to avoid nearly all downside funding risk, despite being nominally responsible for topping up an unfunded plan.[245]

A literature review by the U.S. Government Accountability Office (GAO) showed that research analyzing the reasons for cash balance conversions and their effects on participant benefit levels has been less

freeze, discretionary bonuses for top executives increase by 18.5–29.3 percent. For CEOs, the increased bonus offset 90 percent of the amount of the reduction in the CEO's DB plan benefit. Irina Stefanescu, Yupeng Wang, Kangzhen Xie & Jun Yang, *Pay Me Now (and Later): Pension Benefit Manipulation Before Plan Freezes and Executive Retirement*, 127 J. FIN. ECON. 152, 153 (2018).

238. Rauh et al., *supra* note 231, at 31.

239. *Id.* at 6.

240. *Id.* at 31.

241. *See* Muir & Stein, *supra* note 27, at 536 (discussing conversions of traditional DB plans to cash balance plans).

242. Kevin E. Cahill & Mauricio Soto, *How Do Cash Balance Plans Affect the Pension Landscape?*, CTR. FOR RET. RESEARCH AT BOS. COLL. at 1–2 (2003), https://crr.bc.edu/briefs/how-do-cash-balance-plans-affect-the-pension-landscape/ [https://perma.cc/GX29-K7A6].

243. Dana M. Muir, *Counting the Cash: Disclosure and Cash Balance Plans*, 37 J. MARSHALL L. REV. 849, 856 (2004).

244. Cahill & Soto, *supra* note 242, at 2.

245. *See* Kenneth Glen Dau-Schmidt, *Promises to Keep: Ensuring the Payment of Americans' Pension Benefits in the Wake of the Great Recession*, 52 WASHBURN L.J. 393

(Explaining that an employer "can set the guaranteed rate of return [on investments] low so that the employees bear the investment risk").

conclusive than the research cited above on DB plan freezes.[246] The GAO's own study, though, concluded that employees of all ages are likely to have lower monthly benefits as a result of the conversion of a typical traditional DB plan to a typical cash balance plan.[247] Older, longer-service employees are most likely to have lower benefits in a conversion, particularly if they were close to receiving an early retirement benefit from the DB plan.[248]

At bottom, DB plan sponsors may choose from multiple strategies to shift at least some downside risk. A plan sponsor may terminate an underfunded plan. Or, it may prospectively amend or convert a plan. Depending on the approach used, risk may be shifted to participants, the PBGC, taxpayers, or the social safety net.

ii. Upside Risk

Although under the agency costs analysis, downside risk is the most important factor in identifying the dominant principal, for completeness this subsection considers where upside risk resides in DB plans. Upside risk is a positive outcome. For example, higher investment returns can inure to the benefit of a plan sponsor.[249] Successful investments reduce the sponsor's future plan contribution requirements, may improve the firm's accounting balance sheet, and can generate higher stock prices and thus more lucrative stock options.[250]

However, two sets of statutory mechanisms limit a plan sponsor's ability to take advantage of higher investment returns. First, ERISA and tax law

246. U.S. Gov't Accountability Off., GAO-06-42, PRIVATE PENSIONS: INFORMATION ON CASH BALANCE PENSION PLANS 5 (2005) ("The pension and economic literature provides little conclusive evidence about the effects on benefits and other aspects of CB plan conversions, particularly with regard to why sponsors convert to CB plans in the first place."), https://www.gao.gov/products/GAO–06–42 [https://perma.cc/VL5A-8G67].

247. *Id.* at 37.

248. *Id.* at 20. A report by the Inspector General of the Department of Labor reported that a number of participants did not receive their full accrued, vested benefits as a result of conversions to cash balance plans. David A. Pratt, *Pension Simplification*, 35 J. MARSHALL L. REV. 565, 618 (2002). One practice viewed by many as unfair to longer service employees was the inclusion of wear-away provisions in the cash balance plans. Those provisions essentially prevented longer service employees from earning additional pension benefits for some period of time after the adoption of the new plan. Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 702–04 (2000). Cash balance conversions were so controversial that in 1999 the IRS stopped issuing what are known as determination letters, which provide some degree of comfort to plan sponsors that their plans comply with IRS regulations, while it studied conversions. I.R.S. News Release IR-06-193 (Dec. 21, 2006), https://www.irs.gov/pub/irs-news/ir-06-193.pdf [https://perma.cc/J7X6-N3QC]. The IRS lifted that suspension in late 2006 after Congress enacted legislation addressing some of the most egregious issues with conversions to cash balance plans. *Id.*

249. *See supra* text accompanying note 212.

250. *See* Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1624 (2020) ("According to the complaint, the fiduciaries also made imprudent investments that allowed them to manipulate accounting rules, boost their reported incomes, inflate their stock prices, and exercise lucrative stock options to their own (and their shareholders') benefit.") (Sotomayor, J., dissenting).

prohibit plan sponsors from continuing to contribute to a well-funded plan.[251] The restriction on contributions prevents plan sponsors from taking advantage of both the tax-deductible nature of plan contributions and the tax-exempt status of plan assets to accumulate assets that could revert to them on plan termination.[252] Second, ERISA prohibits plan sponsors from directly accessing the assets of an ongoing plan. Plan assets may only be used to provide benefits to participants and pay plan costs.[253]

If a plan sponsor wants to reach excess assets it has accumulated in a DB plan, the sponsor must therefore terminate the plan. However, excess plan assets that revert to a sponsor on plan termination are subject to an excise tax of up to "a confiscatory 50 percent" in addition to the normal corporate income taxation.[254]

Given these regulatory measures limiting sponsor access to plan assets, plan sponsors experience little of the unlimited residual upside risk enjoyed by equity shareholders and trust beneficiaries. These statutory limitations reflect the foundational goal that plan assets are participants' assets. Plans are not plan sponsor savings accounts.

e. Plan Participants Are the Dominant Principals in DC and DB Plans

The agency costs model developed here treats participants in both DB and DC plans as dominant principals. No debate exists over whether DC participants are dominant principals in those plans.[255] DB participants should also be recognized as the dominant principal in those plans. As explained above, plan sponsors have multiple options to choose from if they wish to shift downside risk to participants and others.[256] Plan terminations, amendments, and conversions all can subvert participants' benefit expectations. The primary function of plans is to provide participants with

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251. Regina T. Jefferson, *Defined Benefit Plan Funding: How Much Is Too Much?*, CASE W. RES. L.R. 1, 2–3 (1993). Plan sponsors are permitted to establish some funding cushion to offset fluctuations in their financial ability to make plan contributions and in the other factors that affect the plan's funding. Muir, *supra* note 243, at 861.

252. Jefferson, *supra* note 251, at 3.

253. ERISA § 403(c)(1), 29 U.S.C. § 1103(c)(1) (2018) ("[T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries and defraying reasonable expenses of administering the plan."); *see also id.* § 404(a)(1), 29 U.S.C. § 1104(a)(1) (requiring fiduciaries to act solely in the interest of plan participants); *cf.* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 446 (1999) ("ERISA, by and large, is concerned with 'ensuring that employees will not be left empty handed once employers have guaranteed them certain benefits' . . . not with depriving employers of benefits incidental thereto.") (citation omitted).

254. Richard A. Ippolito, *Reversion Taxes, Contingent Benefits, and the Decline in Pension Funding*, 44 J.L. & Econ. 199, 200 (2001).

255. *See supra* text accompanying note 360.

256. *See supra* Part III.B.5.d.i.

benefits. Participants trade their labor for those benefits. The permitted backloading of DB benefits means that in their early years of work, participants assume the risk that the plan sponsor may strip them of earned compensation through the shifting of downside risk in later years.

Finally, it is theoretically incoherent for a single entity to act as agent on its own behalf. That would, however, be the case if a plan sponsor served as both the dominant agent and the dominant principal. Commentators such as Fischel, Langbein, and Shnitser observed the problems of categorizing plan sponsors in the primary roles of donative trust actors. [257] Agency costs analysis clarifies why attempting to define the roles of plan sponsors and participants in that way is so frustrating and ineffectual. It is impossible to properly analyze the extent to which interests diverge or to develop appropriate governance mechanisms without understanding which actors fill the predominant roles in the economic agency relationship.

*** *Summary of Basic Agency Costs Model for Employee Benefits*

Applying an agency costs analysis to the roles played by plan sponsors and participants in employee benefit plans provides a new analytic tool to evaluate benefit plan relationships. In the agency costs model for employee benefit plans, participants are the dominant principal in both DB and DC plans. In both types of plans, plan sponsors act as the dominant agent. The next Part applies the model.

IV. APPLICATION: AGENCY COSTS MODEL FOR EMPLOYEE BENEFITS AND THE SETTLOR-FIDUCIARY DOCTRINE

As with the trust law model, the agency costs model for employee benefits law should provide a normative basis to consider appropriate governance mechanisms. Benefits law should minimize the agency costs that result from the employment-based provision of retirement benefits.[258] The positive assessment that follows assesses whether existing law conforms to this normative objective.

This Part interrogates two applications to assess the power of the agency costs model developed in Part III. Both applications relate to the settlor-fiduciary doctrine courts have applied to employee benefit plans. The Part opens by explaining the doctrine. The first application addresses the ability of DB plan participants to bring claims alleging that a fiduciary breach has led to the depletion of plan assets. Specifically, this application considers the

257. *See supra* Part III.C.

258. *Cf.* Sitkoff, *supra* note 10, at 624 ("This Article's normative claim is that the law should minimize the agency costs inherent in locating managerial authority with the trustee (T) and the residual claim with the beneficiaries (B1 and B2), but only to the extent that doing so is consistent with the ex ante instructions of the settlor (S).").

Supreme Court's decision in *Thole v. U.S. Bank*, which held that participants did not have standing to challenge a fiduciary breach that resulted in substantial losses in their DB plan.[259] The second application addresses the extent to which the plan sponsor has fiduciary responsibility for selection of a 401(k) plan's investment menu.

These applications neither provide a complete assessment of the agency costs model for employee benefits law nor are the only applications where the model can provide guidance. Instead, these applications provide an initial stress test of the agency costs model for employee benefits law and its value. Both applications show normative departures from the goal of minimizing agency costs in employee benefits plans.

A. The Settlor-Fiduciary Doctrine

By treating the plan sponsor as two separate actors, the settlor-fiduciary doctrine addresses the tension between a plan sponsor's self-interest and its obligation to participants. For any given act, the plan sponsor is said to wear one of two hats—a settlor hat for acts taken as the "settlor" of the plan, and a fiduciary hat for actions taken as the trustee.[260] According to the settlor-fiduciary doctrine, plan sponsors do not act as fiduciaries when they establish plans, determine or amend plan terms, or terminate plans.[261] All of those actions are categorized as plan design decisions undertaken in the plan sponsor's settlor role.[262] Plan sponsors also do not act in a fiduciary role when they make business decisions that affect the plan or the benefits it provides.[263] The settlor-fiduciary doctrine applies across all types of employee benefit plans.[264]

The Supreme Court grounded its development of the settlor-fiduciary doctrine in ERISA's statutory language. It reasoned that design decisions are not fiduciary acts because the definition of an ERISA functional fiduciary does not refer to discretionary acts that affect plan design.[265] According to the Court, the settlor-fiduciary doctrine promotes plan sponsorship by providing plan sponsors with flexibility in amending their plans and reducing costs

259. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1619 (2020).

260. Muir & Stein, *supra* note 27, at 463.

261. *Id.* at 484. An exception appears to exist for investment-related decisions memorialized in the terms of a DC plan. That exception is explored in detail in Part IV.C, *infra*.

262. Muir & Stein, *supra* note 27, at 494.

263. *Id.* at 481. For a discussion of when employers act as fiduciaries, see *supra* text accompanying notes 189–91.

264. *See* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 445 (1999) (holding that amending a plan to use DB plan assets to provide early retirement incentives to some participants was not a fiduciary act).

265. Lockheed Corp. v. Spink, 517 U.S. 882, 890–91 (1996). For the language of ERISA's functional fiduciary definition, see *supra* note 192.

associated with fiduciary obligations, but that flexibility comes at some cost to participants' benefit expectations.[266]

Hughes Aircraft v. Jacobson is one of the three cases in which the Supreme Court developed the settlor-fiduciary doctrine[267] and serves as a good illustration of its application. The plan sponsor, Hughes Aircraft, made two amendments to its overfunded DB plan.[268] One of the amendments provided a specified subset of participants with a window of opportunity to retire with enhanced early retirement benefits.[269] This "encouraged voluntary separations by older, more expensive employees which, in turn, reduced the plan sponsor's payroll expenses."[270] The amendment also enabled the plan sponsor to decrease its labor force without having to bear the costs of unemployment benefits associated with a layoff.[271] The Court reiterated its earlier guidance: "'[E]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate . . . plans.' When employers undertake those actions, they do not act as fiduciaries but are analogous to the settlors of a trust."[272] Because the enhanced retirement benefits were provided through a plan amendment, the Court held that Hughes held no fiduciary obligations to the participants when structuring the amendment.[273]

The retiree respondents argued that because they made contributions to the DB pension plans, they acted as co-settlors.[274] Presumably they hoped that co-settlor status would require Hughes to obtain their consent for the plan amendments they challenged. The Court, however, looked to trust law to reject their claim. Specifically, the Court relied on trust law's principle that the entity that creates a trust is its settlor. Since the retirees did not create the benefit plan, they could not be considered settlors.[275]

A coauthor and I criticized the settlor-fiduciary doctrine as developed in *Hughes* and other cases.[276] We explained that the doctrine fails to recognize the difference between trust law settlors and plan sponsors' and participants'

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266. *See* Muir & Stein, *supra* note 27, at 515.

267. Dana M. Muir, *The Plan Amendment Trilogy: Settling the Scope of the Settlor Doctrine*, 15 LAB. L. 205, 205 (1999).

268. *Hughes Aircraft Co.*, 525 U.S. at 436.

269. *Id.*

270. Muir, *supra* note 267, at 213.

271. *See Hughes Aircraft Co.*, 525 U.S. at 436 (discussing ways employers may benefit from plan sponsorship).

272. *Id.* at 443 (citation omitted).

273. *Id*. Arguably, because the plan assets were used to pay benefits, the decision would have fulfilled the loyalty obligation of acting for the exclusive purpose of providing benefits. *Id.* at 438–39 (rejecting an anti-inurement challenge on this basis).

274. *Id.* at 444 n.5.

275. *Id*. *But see supra* Part III.B.4 (explaining why the parallel between plan sponsors and trust settlors is weak).

276. *See generally* Muir & Stein, *supra* note 27.

roles in an employee benefit plan.[277] For example, treating the plan sponsor as the sole settlor ignores the participants' economic interests in the plan.[278] As we stated, "[W]hile the settlor/fiduciary doctrine has made it relatively easy for courts to decide cases, it has resulted and will continue to result in decisions that are unmoored from the nuanced policy considerations that animated Congress in enacting ERISA."[279]

B. Application of the Agency Costs Model to Fiduciary Breach in Defined Benefit Plans

In *Thole v. U.S. Bank*, the Supreme Court held that DB plan participants do not have standing to assert fiduciary breach claims, at least in the absence of catastrophic plan and sponsor failure.[280] If the Court had recognized, consistent with the agency costs model described above,[281] that participants are the dominant principals in DB plans, then both the Court's analysis and outcome should have been different.

1. Background in Thole v. U.S. Bank

The plaintiffs, James Thole and Sherry Smith, were participants in U.S. Bank's DB plan.[282] Prior to the 2008 financial crisis, plan fiduciaries invested 100 percent of the plan's assets in equities.[283] The plaintiffs alleged that the aggressive investment portfolio caused the plan to lose $748 million more during the crisis than it would have lost had the assets been appropriately diversified.[284] As a result of the losses, the plan's assets fell to 84 percent of ERISA's minimum funding requirement.[285] The plaintiffs alleged that the investment decisions breached the fiduciaries' duties of prudence, care, and diversification.[286]

The plaintiffs also argued that the fiduciaries' decision to invest plan assets in mutual funds offered by a subsidiary wholly owned by U.S. Bank was made to benefit U.S. Bank and caused the plan to pay higher investment fees than it would have paid for similar mutual funds offered by other

277. *Id.* at 464. For a discussion of the misfit between the various roles, *see supra* text accompanying notes 81–86.

278. Muir & Stein, *supra* note 27, at 464.

279. *Id.* at 460.

280. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1619 (2020).

281. *See supra* Part III.B.

282. *Thole*, 140 S. Ct. at 1618.

283. Thole v. U.S. Bank N.A., 873 F.3d 617, 623–24 (8th Cir. 2017), *aff'd,* 140 S. Ct. 1615 (2020).

284. *Thole*, 140 S. Ct. at 1624 (Sotomayor, J., dissenting).

285. *Thole*, 873 F.3d at 624.

286. *Id.*

firms.[287] The plaintiffs alleged these decisions violated ERISA's fiduciary provisions.[288]

When the plaintiffs filed their lawsuit, the plan's assets were below ERISA's minimum funding standard.[289] The district court held that the plaintiffs had Article III standing because the plan's underfunded status put it at increased risk of default.[290] It dismissed their claims relating to the lack of diversification as beyond the statute of limitations.[291] The court allowed the claims related to the allegedly self-interested mutual fund investments to move forward.[292]

Subsequently, U.S. Bank made a substantial contribution to the plan, which increased the plan's assets above the statutory minimum.[293] Once the plan assets met the minimum funding requirement, U.S. Bank argued that, because the plan was no longer at increased risk of default, the plaintiffs had not experienced any injury-in-fact.[294] Therefore, the suit should be dismissed for lack of Article III standing.[295] The district court instead held that the plaintiffs' remaining claims were moot.[296]

On appeal, the U.S. Court of Appeals for the Eighth Circuit first considered whether ERISA's remedial sections provided standing for plaintiffs' claims.[297] The panel followed Eighth Circuit precedent, which held that ERISA does not provide for monetary relief in claims of fiduciary breach involving plan investments for a DB plan that meets the funding minimum.[298] The Eighth Circuit, however, had never previously addressed whether DB plan participants and beneficiaries could bring that type of claim seeking injunctive relief under ERISA.[299] Over a dissent, the majority parted ways with the U.S. Courts of Appeals for the Third and Sixth Circuits to hold that,

287. *Id.*

288. *Id.* The plaintiffs also alleged a violation of ERISA's prohibited transaction provisions, which, with limited exceptions, ban transactions between a party-in-interest, such as a plan fiduciary or plan sponsor, and a benefits plan. *Id.* at 626.

289. *Id.* at 624.

290. *Id.* at 625.

291. *Id.* at 625–26. Plaintiffs had not made any plausible allegations that would have triggered a duty for the fiduciaries to reexamine the investment strategy. *Id.*

292. *Id.*

293. *Id.* at 626.

294. *Id.*

295. *Id.*

296. *Id.*

297. *Id.* ERISA section 502(a)(2) states that plan participants and beneficiaries have the right to bring suit on behalf of the plan for fiduciary breach. Any monetary relief flows to the plan; the statute also allows for removal of breaching fiduciaries and other legal and equitable relief. Section 502(a)(3) provides plan participants and beneficiaries the right to bring suit for injunctive and other appropriate equitable relief to address a fiduciary breach or other statutory violation. ERISA § 502(a), 29 U.S.C. § 1132(a) (2018).

298. *Thole*, 873 F.3d at 628.

299. *Id.*

because the plaintiffs' benefits had not been reduced, they lacked standing to seek injunctive relief.[300]

2. *Injury-in-Fact Analysis at the Supreme Court*

The main issue before the Supreme Court was whether the plaintiffs had standing under either Article III of the Constitution or ERISA's remedial provisions.[301] Justice Kavanaugh, in a relatively short opinion joined by Chief Justice Roberts and Justices Thomas, Alito, and Gorsuch, held that the plaintiffs lacked Article III standing.[302] The majority believed that the plaintiffs did not have a sufficient stake in the outcome of the lawsuit because, win or lose, they would receive the same amount of monthly DB benefits.[303] The lack of an injury-in-fact also precluded statutory standing.[304]

In concluding that the plaintiffs lacked standing, the majority distinguished DB plans from DC plans and donative trusts. The majority wrote that the rights in a DB plan are "more in the nature of . . . contract" rights than the trust-based equitable or property rights that flow from DC plans and donative trusts.[305] Therefore, the plaintiffs did not have any equitable or property interests in the U.S. Bank plan that could have been harmed by the fiduciaries' investment decisions.[306] Furthermore, according to the majority's view, the plaintiffs did not have any downside risk because the plan specified the plaintiffs' benefit entitlement and participants would receive those benefits.[307] In contrast, the majority believed the plan sponsor held both the upside and downside risk.[308]

Justice Sotomayor authored a lengthy dissent, which Justices Ginsburg, Breyer, and Kagan joined.[309] According to the dissent, the rights of DB plan participants do not significantly differ from the rights of participants in DC plans or donative trusts.[310] In the absence of one of ERISA's exceptions, DB and DC plans must hold assets in trust for the benefit of paying plan

300. *Id.* at 629–30.

301. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1619 (2020). In its grant of certiorari, the Supreme Court directed the parties to address the Article III standing issue in addition to the statutory standing questions the Eighth Circuit had decided.

302. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1619 (2020).

303. *Id.*

304. *Id.* at 1620–21.

305. *Id.* at 1620.

306. *Id.*

307. *See id.* at 1621.

308. *Id.*

309. *Id.* at 1623 (Sotomayor, J., dissenting).

310. *Id*. at 1625. Even assuming that the majority was correct to characterize the defined-benefit plan as primarily contractual, the dissent stated that the plaintiffs should have standing to bring a breach of contract claim for the fiduciaries' alleged actions. *Id*. at 1630–31.

benefits.[311] If, as the majority held, plan participants and beneficiaries are not entitled to the "equitable title to the plan's assets, then no one would" hold that title.[312] The majority had distinguished participants' interests in DB plans from the interests of beneficiaries in donative trusts on the basis that participants in DB plans do not hold the residual risk.[313] Rather than take issue with the placement of residual risk on the plan sponsor, the dissent responded that traditional trust law does not limit equitable interests in trusts to the residual claimants.[314]

The majority also denied the plaintiffs' claim that they had standing as plan representatives. Because they had received all of the pension benefits to which they were entitled and would continue to receive their benefits whether they won or lost the case, the plaintiffs had not suffered any injury-in-fact.[315] Nor could ERISA's remedial sections provide standing where claimants had no injury.[316] The majority seemed to recognize that loss of benefits is not the only type of injury that could give rise to standing for DB participants.[317] In a footnote, the majority distinguished cases involving a sponsor's alleged breach of the duty to provide plan information.[318]

The dissent chided the majority for implying that a financial injury is necessary to establish Article III standing.[319] It is well established in trust law that trust beneficiaries have standing to bring claims for a breach of loyalty even in the absence of any loss to the trust.[320] Further, monetary injury is not required for standing, which is why failure to provide required disclosures

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311. *Id.* at 1625.

312. *Id.* at 1626.

313. *Id.* at 1621 (majority opinion).

314. *Id.* at 1627 (Sotomayor, J., dissenting).

315. *Id.* at 1620 (majority opinion). Nor did Thole and Smith receive an assignment of the plan's potential fiduciary claims. *Id.*

316. *Id.* 1620–21.

317. *Id.* at 1621 n.1.

318. *Id.* The majority refused to address the question of whether participants would have standing if fiduciary mismanagement so compromised plan assets as to risk the failure of the plan and employer because the plaintiffs neither raised that argument below nor did it appear to be factually true in the plaintiffs' own case. *Id.* at 1621–22. The majority, however, inferred that participants would not have standing in such a situation unless their benefits exceeded the PBGC guarantee. *See id.* at 1622 n.2.

319. *Id*. at 1631 (Sotomayor, J., dissenting). The dissent argued that Thole and Smith had standing as representatives of the plan. A plan cannot act on its own; like a corporation, it requires a person to act on its behalf. *Id.* ERISA explicitly provides that a fiduciary, the Secretary of Labor, or participants and beneficiaries may assert a claim for fiduciary breach. 29 U.S.C. § 1132(a) (2018). In the circumstances of this case, the fiduciaries were unlikely to bring a claim against themselves, and the federal government in its amicus brief stated that the Secretary of Labor cannot ensure compliance by all ERISA fiduciaries. *Thole*, 140 S. Ct. at 1636 (Sotomayor, J., dissenting). The dissent argued that the Court's existing precedent on representational standing supported concluding that Thole and Smith had standing. *Id.* at 1632–33. For example, trust law permits a beneficiary to sue as a trust representative when the trustee will not, or cannot, bring the claim. *Id.*

320. Robert H. Sitkoff, *Fiduciary Principles in Trust Law in* THE OXFORD HANDBOOK OF FIDUCIARY LAW 41, 45 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

constitutes a fiduciary breach and, thus, standing.[321] Just as they have rights to information, participants in a plan have a right to loyal and prudent fiduciaries.[322]

Applying the agency costs model for employee benefit plans to the issue in *Thole* suggests that the majority misunderstood the relationships and potential agency costs in DB plans. First, DB plans contain elements of both contract and property law, not just contract law. Yes, plan participants only are entitled to the benefits promised by the plan, but they trade their labor for those benefits and in reliance on plan fiduciaries. One of the reasons for ERISA's enactment was the problem of asset mismanagement and theft that had occurred in the pre-ERISA period.[323] Instead of relying solely on the plan's contract-like obligation to pay benefits, Congress, in enacting ERISA, required most plan assets to be held in trust and incorporated fiduciary obligations based on traditional trust law duties.[324] Use of trusts establishes rights not just of the plan sponsor and participants, but also of third parties.[325] This creates a property dimension to both DB and DC plans.

Agency costs analysis also highlights the oversimplification in the *Thole* majority's statement that plan sponsors hold all of the upside and downside risk in DB plans and the level of plan assets has no effect on participant risk.[326] As explained in Part III.B.5, regulation substantially limits plan sponsors' upside risk.[327] Certainly they are situated very differently in that respect from trust beneficiaries and equity shareholders. Part III also explained the considerable extent to which plan sponsors may shift downside risk to plan participants and capture a wealth transfer from those participants at the same time.[328] In fact, U.S. Bank's actions exemplify the risks to participants of plan losses. The alleged fiduciary breaches caused an estimated $748 million in losses in 2008.[329] Effective in 2010, U.S. Bank put in place a soft freeze on its traditional DB plan, added a cash balance plan for new hires, and moved existing employees to the cash balance plan if they elected to change plans.[330] Sufficient information is not available to determine whether the losses that resulted from the fiduciary breaches were

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321. *Thole*, 140 S. Ct. at 1631–32 (Sotomayor, J., dissenting).

322. *Id.* at 1632.

323. *See* Shnitser, *supra* note 16, at 632.

324. *See id.*

325. *E.g.*, Sitkoff, *supra* note 10, at 631–33 (discussing Professors Henry Hansmann and Ugo Mattei's insight that using a trust provides the unique ability to organize the rights and obligations of third parties in addition to the rights and obligations of the parties who hold the primary roles of trustee, settlor, and beneficiary).

326. *See* Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1620 (2020).

327. *Supra* Part III.B.5.d.ii.

328. *Supra* Part III.B.5.d.i.

329. *Thole*, 140 S. Ct. at 1624 (Sotomayor, J., dissenting).

330. Complaint at 7–8, Smith v. U.S. Bancorp, No. 18–3405 (D. Minn. Dec. 14, 2018), https://ikrlaw.com/wp-content/uploads/2019/01/1-Complaint-2.pdf [https://perma.cc/J2ER-6AHV].

at least part of the reason for the adoption of the cash balance plan or whether employees lost benefits because of the change. Adoption of the cash balance plan, however, is consistent with the research showing cash balance conversions tend to follow DB plan funding issues.[331]

3. *Analysis of Constraints on Fiduciary Misbehavior*

Normatively, the agency costs model calls for dominant agents to act on behalf of the dominant principals and for those obligations to be legally enforceable. Neither active monitoring nor limitations on the agents' discretion sufficiently address the conflicts of interest that are inherent in agency relationships.[332] The normative solution to this problem is to impose fiduciary duties, which at their core operate to deter fiduciary misconduct.[333] As a matter of positive law, ERISA explicitly establishes fiduciary obligations on agents with discretion, which includes dominant agents.[334] The *Thole* decision, however, undermined the strength of those obligations by severely limiting the set of potential claimants when fiduciaries breach their duties.

The *Thole* plaintiffs contended that there would be insufficient constraints on fiduciary misconduct unless plaintiffs and beneficiaries could bring claims to enforce ERISA's prohibitions on misconduct.[335] The majority rejected that contention, pointing out that plan sponsors and shareholders have an interest in ensuring fiduciary loyalty and prudence because, in DB plans, plan sponsors are obligated to make up for any deficit in plan funding.[336] The majority also noted that the Department of Labor (DOL) has both the power and the incentive to enforce ERISA's fiduciary obligations.[337] The question raised in amicus briefs—whether participants would have standing if "the mismanagement of the plan was so egregious that it substantially increased the risk that the plan and the [plan sponsor] would fail and be unable to pay the participants' future pension benefits"—went unanswered.[338]

The dissent responded that plan sponsors and shareholders have conflicts of interest that the majority missed or ignored. As Justice Sotomayor wrote, "The employer, its shareholders, and the plan's cofiduciaries here have no reason to bring suit because they either committed or profited from

331. *See supra* text accompanying notes 241–47.
332. Sitkoff, *supra* note 90, at 199.
333. *Id.* at 201.
334. *See supra* text accompanying notes 191–91.
335. Thole v. U.S. Bank N.A., 140 S. Ct. 1615, 1621 (2020).
336. *Id.*
337. *Id.*
338. *Id.* at 1621–22.

the misconduct."[339] The dissent also pointed out the fallacy in the implication that the DOL is willing and able to pursue all benefits cases involving statutory violations.[340] Even if the DOL brings an enforcement action against a DB plan fiduciary whose breach of duty resulted in losses of plan assets, that does not mean the DOL will seek or win the types of relief plan participants would have requested.[341]

Agency costs analysis both calls into question the *Thole* majority's reasoning and reinforces the dissent's analysis. The conflicts of interest between the plan sponsor and its shareholders (as dominant agents) and the participants (as dominant principals) generate agency costs that can be mitigated by appropriate governance mechanisms.[342] Governance mechanisms have little value, however, if they are not enforced. As explained above, the firm, management, and shareholders may benefit from fiduciary investment decisions that incur undue risk.[343] Those actors also may benefit if the plan sponsor's reaction to asset losses was to freeze the plan and transfer wealth from participants to the firm.[344]

The *Thole* majority appeared troubled by the potential for excess litigation costs if participants had the right to challenge the actions of the agents that owe them fiduciary obligations.[345] Agency costs analysis reminds us, though, that participants face significant litigation barriers. As Sitkoff explained, "When liability rules are the chief check on agency costs, there is a practical limit to the number of residual claimants that the organization can support."[346] Pension plans often have large numbers of participants.[347] The result is a collective action problem, where individual participants have only a small incentive to monitor and potentially litigate. This should mitigate the majority's concern and reinforces the need for strict governance measures to minimize agency costs.

4. *Application of Trust Law Principles to Employee Benefits Law*

Justice Thomas's concurrence in *Thole*, which Justice Gorsuch joined, signals a potential pathway for the adoption of agency costs analysis by

339. *Id.* at 1636 (Sotomayor, J., dissenting).

340. *Id.* at 1636–37; see also Dana M. Muir, *Decentralized Enforcement to Combat Financial Wrongdoing in Pensions: What Types of Watchdogs Are Necessary to Keep the Foxes Out of the Henhouse?*, 53 AM. BUS. L.J. 33, 68–71 (2016) (discussing limitations on DOL enforcement).

341. *Thole*, 140 S. Ct. at 1636–37.

342. *See supra* text accompanying notes 106–08 (discussing the role of fiduciary principles in establishing governance mechanisms to mitigate agency costs).

343. *Supra* text accompanying notes 249–49.

344. *Supra* text accompanying notes 236–40.

345. *Thole*, 140 S. Ct. at 1619 ("No small thing, the plaintiffs also sought attorney's fees. In the District Court, the plaintiffs' attorneys requested at least $31 million in attorney's fees.").

346. Sitkoff, *supra* note 10, at 679.

347. *Id.* at 681.

courts.[348] Thomas raised a concern that dates back to his dissent in a 1995 ERISA case involving allegations of fiduciary breach.[349] In Thomas's view, the Supreme Court has relied too heavily on the common law of trusts in ERISA cases.[350]

Some Justices who often have disagreed with Justice Thomas have also objected to the Court's use of trust law principles in ERISA cases. Justice Ginsburg may have been the strongest critic of the Court's insistence on limiting equitable remedies based on the "archaic and unyielding doctrine" that distinguished equitable from legal restitution.[351] In *Great-West*, Justice Ginsburg, in a dissent joined by Justices Stevens, Souter, and Breyer, criticized the majority for "treat[ing] as dispositive an ancient classification unrelated to the substance of the relief sought; and . . . obstruct[ing] the general goals of ERISA."[352]

At least as early as 1996, the Supreme Court opined that it should not blindly apply trust law principles in to benefits law issues. As it stated then:

> [T]rust law does not tell the entire story. After all, ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection . . . . And, even with respect to the trust-like fiduciary standards ERISA imposes, Congress "expected that the courts will interpret this prudent man rule (and the other fiduciary standards) bearing in mind the special nature and purpose of employee benefit plans."[353]

The agency costs analysis proposed in this Article could satisfy the concerns of Justices on both sides of the liberal-conservative spectrum. The agency costs analysis's more nuanced application of fiduciary principles may address the belief that the Court relies too heavily on trust law principles.[354] Agency costs analysis requires a careful evaluation of the types of conflicts of interest identified by the dissent.[355] Consideration of how fiduciary governance mechanisms, including their enforcement, can mitigate agency costs would provide a theoretically coherent approach to adapting trust law concepts to the relationships in benefit plans.

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348. *See Thole*, 140 S. Ct. at 1622.

349. Varity Corp. v. Howe, 516 U.S. 489, 526–36 (1996) (Thomas, J., dissenting).

350. *Thole*, 140 S. Ct. at 1623 (Thomas, J., concurring) ("I continue to object to this Court's practice of using the common law of trusts as the 'starting point' for interpreting ERISA.").

351. *See* Great-W. Life & Annuity Ins. v. Knudson, 534 U.S. 204, 228 (2002) (Ginsburg, J., dissenting); *see generally* Muir, *supra* note 191 (discussing the Court's ERISA remedial jurisprudence).

352. *Great-W.*, 534 U.S. at 224.

353. *Varity Corp.*, 516 U.S. at 497 (internal citation omitted).

354. *See supra* text accompanying notes 349–49 (citing Justice Thomas's views).

355. *See supra* text accompanying notes 339–40.

C. Investment Menu Selection in 401(k) Plans

The responsibility, and resulting fiduciary obligations, for investment decisions in 401(k) plans is more complicated than in DB plans. No single legal case or doctrine illustrates the threats posed by overreliance on the parallels between relationships in trust law and relationships in benefit plans. This Section begins by explaining two broad types of issues related to the appropriate governance mechanisms for plan investment decision making. The first issue is the application of the settlor-fiduciary doctrine to the determination of liability for investment decisions in 401(k) plans. The second is the large menu defense to fiduciary breach claims. That defense argues that so long as a plan menu has at least one reasonable option, there has been no fiduciary breach in the selection of investment options. The Section then applies the agency costs model developed in Part III to those issues.

1. Allocation of Liability for Investment Decisions in 401(k) Plans

401(k) plans can, and usually do, delegate responsibility for making investment decisions regarding their account assets to participants.[356] In these participant-directed plans, participants are able to choose from an investment menu.[357] ERISA shields dominant agents and other actors associated with the plan from fiduciary responsibility for the specific investment decisions made by participants when participants "exercise[] control" over account assets.[358] Regulations provide a safe harbor for plans that include sufficient investment alternatives and access to information about those alternatives.[359]

The agency costs model recognizes participants as the dominant principals in 401(k) plans because their benefits depend entirely on their individual account balances and they earn all contributions made to the plan with their labor.[360] The plan sponsor has an interest in the investment outcomes in the sense that the sponsor benefits if employees value the plan.[361]

356. Muir & Stein, *supra* note 27, at 498.

357. *Id.* Some plans add what is known as a "brokerage window" to the list of designated investment alternatives on the plan's investment menu. Typically, an additional administrative fee is charged for participants who choose to use the brokerage window, which enables the participants to choose from a significantly larger set of investments. It remains unclear whether fiduciaries have an obligation to monitor the investments available in the window or how the inclusion of a window in a plan affects the fiduciary monitoring obligations of the designated investment alternatives. Some scholars have argued that it would be bad policy to immunize fiduciaries of plans that include brokerage windows. Ian Ayers & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L.J. 1476, 1485, 1508 (2015).

358. *See* ERISA § 404(c)(1)(A), 29 U.S.C. § 1104(c)(1)(A) (2018).

359. 29 C.F.R. § 2550.404c-1(b) (2010).

360. *See supra* notes 40-41.

361. *But see* Mercer Bullard, *The Social Costs of Choice, Free Market Ideology and the Empirical Consequences of the 401(k) Plan Large Menu Defense*, 20 CONN. INS. L.J. 335, 363–64 (2014) (noting

Overall, however, menu selection fits squarely within the concerns of agency costs theory. Plan sponsors as dominant agents determine the investment options from which their principals—the participants—must choose when investing their assets. As plan sponsors make those decisions, they may benefit from slacking or from more direct self-interested decision-making. Plan sponsors bear the costs of assembling a menu of appropriate options or hiring experts to advise them in those selections, yet they gain little to nothing from the expenditures.[362] They may also benefit more directly from selecting some investments rather than others. For example, instead of including better performing, lower fee funds from a competitor, a plan sponsor may include in the investment menu funds that it owns and from which it receives fees.[363] The following subsections address two areas of benefits law where the law is murky on the appropriate governance mechanisms to reduce these agency costs.

i. Investment Menus as Settlor or Fiduciary Decisions

In theory, the settlor doctrine would enable a plan sponsor to insulate itself from all fiduciary liability associated with the initial selection and subsequent monitoring of the investment menu. The general operation of the settlor-fiduciary doctrine suggests that if the plan sponsor includes the investment menu in the plan's terms, then all decisions about the menu become part of adopting or modifying the plan. According to the settlor-fiduciary doctrine, decisions about plan terms are not fiduciary decisions.[364] In *Hughes Aircraft v. Jacobson,* the Supreme Court's guidance appeared unambiguous: "'[E]mployers or other plan sponsors are generally free under ERISA, for any reason at any time, to adopt, modify, or terminate . . . plans.' When employers undertake those actions, they do not act as fiduciaries but are analogous to the settlors of a trust."[365] A recent Supreme Court opinion, though, indicates there may be an exception from the protections of the settlor-fiduciary doctrine for 401(k) plan menus.[366]

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that employers gain financially when employees do not contribute to 401(k) plans and thus forfeit any employer-matching contributions).

362. George S. Mellman & Geoffrey T. Sanzenbacher, CTR. FOR RET. RESEARCH AT BOS. COLL., *401(k) Lawsuits: What are the Causes and Consequences?*, at 3 (2018), https://crr.bc.edu/wp-content/uploads/2018/04/IB_18-8.pdf [https://perma.cc/G5FA-QL9R] (noting that fiduciaries may fail to exercise sufficient due diligence in the selection of investments for a 401(k) plan menu).

363. *Id.* at 4 (reporting lawsuits involving forty financial firms where the firms often offered their own funds in the 401(k) plan).

364. Wiedenbeck, *supra* note 28, at 1067.

365. Hughes Aircraft v. Jacobson, 525 U.S. 432, 443 (1999) (citations omitted). For a discussion of the *Hughes Aircraft* decision, *see supra* text accompanying notes 267–74.

366. *See infra* text accompanying notes 369–82.

Some history is useful. Before the Supreme Court first outlined what came to be known as the settlor-fiduciary doctrine,[367] the DOL designated selection of investment options as a fiduciary function:

> [T]he act of limiting or designating investment options which are intended to constitute all or part of the investment universe of a [participant-directed 401(k)] plan is a fiduciary function . . . whether achieved through fiduciary designation or express plan language . . . . Thus . . . the plan fiduciary has a fiduciary obligation to prudently select such [investment options], as well as a residual fiduciary obligation to periodically evaluate the performance of such [investment options].[368]

The Supreme Court now appears to agree with the DOL, although the question the Court addressed, in *Fifth Third Bancorp v. Dudenhoeffer*, was not exactly on point.[369] In that case, former employees of Fifth Third Bancorp alleged that their ESOP's fiduciaries breached the duty of prudence by not decreasing the plan's holdings of company stock when the "fiduciaries knew or should have known that Fifth Third's stock was overvalued and excessively risky."[370] The Circuits that had addressed the issue previously had developed a presumption that ESOP investments in plan sponsor stock met the prudence requirement.[371] The Supreme Court rejected that presumption.[372]

The ESOP's fiduciaries argued, among other things, that ESOPs have a special purpose in addition to the ordinary benefit plan purposes, with the special purpose being to "promote employee ownership of [plan sponsor] stock."[373] The decision to continue the investment in plan sponsor stock was consistent with that special purpose and was owed deference.[374] The Court rejected the notion that the fiduciaries could take into account a nonpecuniary goal, such as employee ownership, even if the plan sponsor memorialized that goal in the plan's terms.[375] The Supreme Court reasoned that "the duty of prudence trumps the instructions of a plan document" because ERISA only

367. *See* Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 78 (1995).

368. Final Regulation Regarding Participant Directed Individual Account Plans (ERISA Section 404(c) Plans), 57 Fed. Reg. 46,906, 46,924 n.27 (Oct. 13, 1992) (codified at 29 C.F.R. § 2550.404c-1).

369. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409 (2014); *see* Brief for the U.S. as Amicus Curiae Supporting Certiorari at 11, *Hughes v. Nw. Univ.*, No. 19-1401 (U.S. May 25, 2021) (citing the *Dudenhoeffer* rationale in a 401(k) case).

370. *Id.* at 413.

371. Wiedenbeck, *supra* note 28, at 1066 n.249; *see also Fifth Third Bancorp*, 573 U.S. at 414 (explaining the Court had granted certiorari "[i]n light of differences among the Courts of Appeals as to the nature of the presumption of prudence applicable to ESOP fiduciaries").

372. *Fifth Third Bancorp*, 573 U.S. at 412.

373. *Id.* at 419–20.

374. *Id.* at 420.

375. *Id.* at 420–21.

permits fiduciaries to follow plan documents to the extent those documents are consistent with the statute.[376]

Professor Wiedenbeck observed that the Court's holding appears to be inconsistent with a strong form of the settlor-fiduciary doctrine.[377] That doctrine would have immunized decisions made in accordance with the plan document's direction that assets be invested in stock of the plan sponsor from fiduciary obligation. In its decision in *Fifth Third Bancorp*, the Supreme Court did not explain the implicit distinction it drew between plan terms that govern the plan's investments in sponsor stock and the Court's otherwise uniform application of the settlor-fiduciary doctrine to categorize plan terms as settlor, not fiduciary decisions. In fact, the Court never mentioned the settlor-fiduciary doctrine.[378]

The Supreme Court's failure to apply the settlor-fiduciary doctrine might be rationalized in a number of ways. Wiedenbeck posited that the Court may view plan sponsor decisions on plan investments as an "inherent fiduciary function."[379] A similar but broader interpretation of the *Fifth Third Bancorp* logic is that decisions regarding plan assets always should be categorized as decisions on the management of plan assets rather than as design decisions.[380] Under ERISA, a fiduciary includes anyone that "exercises any authority or control respecting *management* or disposition of [plan] assets."[381] Applying the asset management concept to ESOPs, determinations on whether employer stock is an appropriate plan investment constitute management of plan assets and, thus, fiduciary decisions. This understanding would categorize all decisions on investment menus in 401(k) plans as fiduciary decisions.

Arguably, immunizing the choice and monitoring of designated investment options that are included in a plan's terms is inconsistent with ERISA's prohibition on exculpatory provisions. The statute explicitly proscribes "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part."[382] Treating investment options included in the plan document as being outside fiduciary obligation essentially would act as a provision that shields the plan fiduciaries from the duty of prudence and perhaps even loyalty.[383]

376. *Id.* at 421.
377. Wiedenbeck, *supra* note 28, at 1067.
378. *Id.* at 1068.
379. *Id*.
380. Muir & Stein, *supra* note 27, at 534.
381. ERISA § 3(21)(A)(i), 29 U.S.C. § 1002(21)(A)(i) (2018) (emphasis added).
382. ERISA § 410(a), 29 U.S.C. § 1110(a).
383. I thank Norman Stein for this insight.

ii. Large Menu Defense and Pleading Standard

Ian Ayres, Quinn Curtis, and Mercer Bullard have criticized the "large menu defense," which courts have relied upon to deny some fiduciary breach claims that arise from a plan sponsor's selection and monitoring of plan investment menus.[384] Bullard attributed the doctrine to courts' belief in the efficiency of free markets.[385] At its most extreme, the large menu defense insulates a plan sponsor from liability for choosing and retaining investment options even where there is no question that one or more of the options have egregiously high fees or horrible performance, and even though other options would clearly be better if the plan sponsor met its fiduciary obligation with respect to a single option in the menu.[386]

The large menu defense not only undermines the fiduciary obligations of plan sponsors, it also may discourage plan participation by incentivizing plans to include many options.[387] The behavioral economics literature is clear—increasing the number of available choices discourages people from making any choice.[388] In the 401(k) context, studies show that large investment menus reduce the percentage of employees who choose to participate in the plan.[389] Other studies show that large menus are more likely to have less effective disclosures, higher fees, and result in participants making worse investment allocation choices.[390]

The courts are divided on pleading requirements for claims alleging that fiduciary breaches led to excessively costly investment options in a plan menu.[391] The Supreme Court has granted certiorari in *Hughes v. Northwestern University* to address that issue.[392] The Third and Eighth Circuits recognize claims as adequately pled if they allege that a 401(k) plan included one or more investments with excessive fees instead of lower-cost alternatives.[393] These decisions appear to be consistent with guidance from the Supreme Court that plan fiduciaries must periodically review the

384. Bullard, *supra* note 361, at 336; *see also* Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L.J. 1476, 1482 (2015).

385. Bullard, *supra* note 361, at 336.

386. *See id.* at 340–48 (explaining the large menu defense).

387. *Id.* at 351.

388. *Id.* at 361.

389. *Id.*

390. *Id.*

391. *See infra* text accompanying notes 393–95.

392. Hughes v. Nw. Univ., 141 S. Ct. 2882 (2021), *vacated*, No-19-1401, 2022 U.S. LEXIS 622, at *12 (Jan. 24, 2022). The Supreme Court decided the case late in the publication process of this Article. Consistent with the agency costs analysis suggested in this Article, the Court held that plan sponsors have a duty to monitor all of the plan's investment options. *Id.* at *9–10.

393. Davis v. Wash. Univ., 960 F.3d. 478, 483 (8th Cir. 2020); Sweda v. Univ. of Pa., 923 F.3d 320, 332 (3d Cir. 2019).

suitability of all options in a plan menu.[394] In contrast, the Seventh Circuit held in *Northwestern*[395] that because participants could instead invest in one or more of the many other plan investment options, the participants could not state a claim by pleading that lower-cost alternatives to some of the options existed.[396] The Seventh Circuit essentially relied on the logic of the large menu defense to reject the plaintiffs' claims.

B. *Application of Agency Costs Model to 401(k) Plan Menus*

The agency costs model for employee benefits suggests that plan sponsors act as dominant agents when making decisions on investment menus in 401(k) plans and employer stock in ESOPs. As explained above, in these situations, the plan sponsors' interests depart from the plan participants' interests.[397] The participants, as principals, will bear the agency costs from high fees, poorly performing investments, and plan menus designed to protect the plan sponsor rather than facilitate plan participation and optimal investment choices. Those agency costs may spill over to society. High-fee investments or savings achieved by failing to loyally or prudently choose or monitor investments enable plan sponsors or financial services firms to divert to themselves a portion of the tax incentives intended to support retirement savings. Social safety net costs will increase if it becomes necessary to support retired workers who participated in plans in which agency costs depleted their account assets.

In bringing litigation to enforce their rights related to plan investments, ESOP and 401(k) plan participants face collective action hurdles that are similar but potentially more burdensome to those faced by participants in DB plans.[398] Participants in 401(k) plans each make the investment decisions for their individual plan accounts. To the extent they make different investment selections from the plan's menu, the participants will not have uniform interests in challenging particular offerings in a plan's investment menu. The coordination problem across various substandard investment options may be significant. In addition, the monitoring costs for 401(k) plan participants may be even higher than the costs in DB plans, particularly in plans with large investment menus. Investment disclosures and comparisons are complex. The larger the universe of options that need to be monitored by participants, the higher the costs to those participants.

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394. Tibble v. Edison Int'l, 135 S. Ct. 1823, 1828 (2015).

395. This Article refers to the case in short form as "Northwestern" to distinguish it from discussions above of Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 445 (1999).

396. Divane v. Nw. Univ., 953 F.3d 980, 988–89 (7th Cir. 2020), *vacated sub nom.* Hughes v. Nw. Univ., No-19-1401, 2022 U.S. LEXIS 622, at *12 (Jan. 24, 2022).

397. *See supra* text accompanying notes 362–62.

398. *See supra* text following note 347.

In sum, the agency costs analysis supports positive law that holds plan sponsors—the dominant agents—accountable for the selection and monitoring of a 401(k) plan's menu. As Sitkoff observed, the standard positive law approach to agency problems is to impose fiduciary obligations on the agents.[399] By treating designation of plan menu options in the plan document as a settlor function, and beyond the scope of fiduciary duty, courts would ignore the agency function of the plan sponsor. Perhaps even worse, the large menu defense rewards the plan sponsor, as agent, for deciding to offer a large number of investment options, including subpar options—a decision that is in the plan sponsor's interest but costly to the participants who are their principals. No other area of U.S. law leaves principals so vulnerable to this type of self-dealing or slacking by their agents.[400]

CONCLUSION

Courts have long tried to force employee benefit plan relationships into the pigeonholes of donative trust law. Scholars have bemoaned the results. In *Thole*, the Supreme Court recently perverted bedrock fiduciary principles when it held that participants in a pension plan did not have standing to bring fiduciary claims alleging violations of the duty of prudence and loyalty associated with self-dealing and the loss of almost $750 million in assets.

It is past time to bring a new lens to bear on the challenges of building plan governance mechanisms that will enable U.S. workers to accumulate the financial resources they need for a secure retirement and decrease the social safety net costs of supporting superannuated individuals. This Article broke new ground by sketching an agency costs model to conceptualize the relationship between benefit plan sponsors and plan participants. Instead of trying to jam plan sponsors and participants into trust law's three paradigmatic actors (settlors, trustees, and beneficiaries), the agency costs model reframes key questions. The model enables normative insights on how governance mechanisms may mitigate agency costs.[401] It also illuminates how those normative insights can be used to improve positive law.[402]

Plan governance mechanisms, particularly the extent and intensity of fiduciary obligation, should be structured to focus on the costs generated by agents when their interests diverge from the interests of their principals. This Article concluded that employers typically act as the dominant agents in both DB and DC plans, and on behalf of employees who are the dominant

399. Sitkoff, *supra* note 90, at 200.

400. *See id.* ("[T]he difficult task for legal institutional design is to 'protect[] the principal from the vulnerability that any relationship of agency creates by exposing the principal's property or interests more generally to the risk of self-interested action by the agent.'") (quoting RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (AM. LAW INST. 2006)).

401. *See supra* Part IV.B–C.

402. *See id.*

principals. That identification facilitates recognition of the conflicts of interest held by the dominant agents.

Agency costs analysis also suggests that positive law should recognize that trust law and employee benefits law differ in their foundational goals. Trust law is built to enable intergenerational transfers. Employee benefits law ideally serves multiple functions, including encouraging and enabling workers to build retirement wealth.[403] If successful, the system maximizes the efficiency of the tax expenditures on DB and DC plans and relieves pressure on the social safety net to care for aging Americans who no longer can work.[404]

403. *See supra* text accompanying notes 21–22.

404. *Id.*