C. Discussion of Specific Issues

1. Phase out of the ESOP offset under the Enron Corp. Retirement Plan

Present Law

Floor-offset arrangements in general

A "floor-offset arrangement" coordinates benefits from a defined benefit plan with those of a defined contribution plan.[1348] The defined benefit plan, the "floor," establishes a minimum benefit level in accordance with the benefit formula specified by the plan. The defined contribution plan provides the "offset." The projected value of the participant's benefit under the defined contribution plan offsets the amount of the participant's benefit payable under the defined benefit plan. If the offset provides a benefit at least equal to the minimum established under the floor, the participant receives the balance of the defined contribution plan account. In such cases, no benefit is paid from the floor plan. If, however, the defined contribution plan provides less than the minimum benefit established under the floor plan, e.g., as a result of investment performance, benefits will be paid from the floor plan to make up the shortfall in the defined contribution plan benefit. That is, the different between the floor benefit and the defined contribution plan benefit will be paid from the defined benefit plan. The benefit under a typical floor-offset arrangement payable at normal retirement age generally can be determined through the following steps:

(1) the initial monthly vested benefit under the defined benefit Plan formula is determined (the "gross benefit");

(2) the vested account balance in the defined contribution plan is determined;

(3) the accumulated vested account balance is converted to an actuarially equivalent monthly accrued benefit, using the interest and mortality factors in the plan document;[1349] and

(4) if the amount determined in step (3) is greater than that determined in step (1), no benefits are due from the defined benefit plan and all benefits will be paid from the defined contribution plan. If the amount determined in step (1) is greater than the amount determined in step (3), the participant is entitled to the vested account balance in the defined contribution plan plus--from the defined benefit plan--an amount equal to the difference between step (1) and step (3).

[1348] *See* Part II.A.2., above, for a definition of defined benefit plans and defined contribution plans.

[1349] Although this actuarially equivalent benefit is used as the offset amount, the defined contribution plan is not actually required to provide such a benefit to participants.

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If the benefit is payable prior to normal retirement age, then the vested account balances in the defined contribution plan is projected to normal retirement age, using the interest factor specified in the plan, before performing step (3).

Floor-offset arrangements, particularly those involving ESOPs, can be attractive from the perspective of both employers and employees. Present law encourages the establishment of ESOPs by providing special tax benefits to employers that adopt such plans.[1350] A floor-offset arrangement involving an ESOP generally allows participants to benefit from an increase in value of the employer securities held by the ESOP, while protecting them from losses in value by providing a minimum floor benefit under the defined benefit plan. The benefit under the defined benefit plan is guaranteed by the PBGC, thus providing additional protection. A plan sponsor might establish a floor-offset arrangement because such arrangements may offer employees the better of two worlds: there is a defined contribution plan benefit and a minimum benefit from a defined benefit plan. As described below, floor-offset arrangements involving defined contribution plans with large investments in employer securities, such as ESOPs, were found to present additional exposure to the PBGC compared to a typical defined benefit plan, and rules relating to such plans were changed in 1986, which had the effect of prohibiting floor-offset plans involving ESOPs.

Code provisions relating to floor-offset arrangements

Background (Rev. Rul. 69-502, 1969-2 C.B. 89)

Prior to the enactment of ERISA in 1974, the IRS took the position in a Revenue Ruling that neither the defined benefit plan portion nor the defined contribution plan portion of a floor offset arrangement would meet the Code's qualification requirements.[1351] The Ruling involved a floor-offset arrangement consisting of a defined benefit plan and a defined contribution profit-sharing plan. In it, the taxpayer had established a defined contribution plan and a defined benefit plan for the same employees. The defined benefit plan provided a monthly retirement benefit after age 65 equal to 50 percent of each employee's average annual compensation, offset by the actuarial value of any amounts to which the employee might be entitled under the defined contribution plan. In the ruling, the IRS addressed whether the provision for offsetting benefits under the defined benefit plan by amounts received under the first affected the qualification of the plans.

With respect to the defined contribution plan, the IRS held that since the funds held in an employee's account under the defined contribution plan would be used to reduce the employee's benefits under the second plan, the employer will be relieved from contributing to the second plan to the extent of those funds. Thus, the first plan is not for the exclusive benefit of the

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[1350] Present law affecting employers adopting ESOPs is discussed in Part II.A.2., above.

[1351] Rev. Rul. 69-502, 1969-2 C.B. 89

employees in general within the meaning of the regulations.[1352] Accordingly, it was held that the plan did not meet Code requirements for tax qualification.

Additionally, the IRS held that with respect to the defined benefit plan, because the amount of benefits payable out of the funds held under the plan was contingent upon the amount available under the defined contribution plan, the benefits an employee will receive under the second plan are not definitely determinable as required by applicable Treasury Regulations.[1353] In particular, the requirement that the amount of benefits not depend on the plan sponsor's profitability would be violated because the benefits under the defined benefit plan would depend on the assets in the profit-sharing plan, and the profit-sharing plan depended on the profits of the employer. Accordingly, it was held that the plan does not meet Code requirements for tax qualification.

Present-law rules

In 1976, the IRS reversed its position in a Revenue Ruling, citing a Code provision which was added by ERISA.[1354] Again considering a floor-offset arrangement involving a defined benefit pension plan and a defined contribution profit sharing plan, the IRS succinctly concluded that under the Code "as amended by ERISA an arrangement described in [the Revenue Ruling] does not fail to satisfy the requirements...of the Code...merely because of the type of such arrangement." Under the new Code provision, a defined benefit plan generally may qualify even though it provides benefits derived from employer contributions based partly on the balance of the separate account of participants.[1355] Such a hybrid plan is treated as a defined contribution plan for some purposes and a defined benefit plan for other purposes.[1356]

The 1976 Revenue Ruling provides that the defined benefit plan part of a floor-offset arrangement must specify the actuarial basis that will be used to determine the benefit after offset. Thus, the plan must specify the interest and mortality assumptions to be employed, as well

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[1352] Treas. Reg. sec. 1.401-1(b)(3), enacted before ERISA, provides that a qualified plan must benefit the employees in general even though it need not provide benefits for all the employees. That section also provides that a profit-sharing plan is not for the exclusive benefit of the employees in general if the funds therein may be used to relieve the employer from contributing to a pension plan operating concurrently and covering the same employees.

[1353] Treas. Reg. sec. 1.401-1(b)(1)(i), enacted before ERISA, provides that a pension plan, within the meaning of sec. 401(a), is a plan established and maintained by the employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. Under Treas. Reg. sec. 1.401(a)-1(b)(i), the definitely determinable benefit requirement continues to apply under ERISA.

[1354] Rev. Rul. 76-259, 1976-2 C.B. 111.

[1355] Pub. L. No. 93-406, sec. 1015 (1974).

[1356] Sec. 414(k).

as the date as of which the determination shall be made, in a way that precludes discretion on the part of the employer. Additionally, the Revenue Ruling indicates that the benefits under a defined benefit plan will not fail to be definitely determinable merely because the defined contribution plan does not have a definite contribution formula. Thus, even though contributions to the defined contribution plan may vary from year to year, the defined benefit plan benefit is not precluded from being definitely determinable. The Revenue Ruling provides that the determination of whether the defined benefit plan satisfies accrual rules under the Code may be made based on the pre-offset benefit in certain cases. Finally, only the vested benefit in the defined contribution plan may be used to offset the benefit under the defined benefit plan.

Generally, any defined benefit plan may be part of a floor-offset arrangement. There are, however, restrictions on the types of defined contribution plans that may be part of a floor-offset arrangement. Specifically, defined contribution plans with section 401(k) cash or deferred arrangements may not be part of a floor-offset arrangement because of the requirement that no benefits other than matches may be conditioned on whether the employee makes or does not make elective deferrals.[1357] However, arrangements established by April 16, 1986, are not subject to this restriction.[1358]

Like other qualified plans, floor-offset arrangements are subject to the Code's qualification requirements. Because floor-offset arrangements combine the features of two different types of plans, special rules are applied in some cases, particularly to reconcile the differences between the rules that apply only to one type of plan. For example, defined benefit plans are subject to joint and survivor annuity requirements that do not apply to many defined contribution plans. To reconcile this difference, Treasury regulations provide that the defined contribution portion of a floor-offset arrangement must comply with qualified joint and survivor requirements even if the plan would not otherwise be subject to those requirements.[1359]

One of the generally applicable qualification requirements that is relevant to the Enron floor-offset arrangement is the "anticutback" rule, which provides that an amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant.[1360] An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit.[1361]

[1357] Sec. 401(k)(4)(A).

[1358] Pub. L. No. 99-514, sec. 1116(f)(5) (1986).

[1359] Treas. Reg. sec. 1.401(a)-(20), Q&A 5(a).

[1360] Sec. 411(d)(6) and sec. 204(g) of ERISA.

[1361] With respect to the effect of an amendment on future benefits, the Code and ERISA provide that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual (including any elimination or reduction of a significant early retirement benefit or retirement-

For purposes of these rules, a participant's accrued benefit under a defined benefit plan is generally the participant's accrued benefit determined under the plan and expressed in the form of an annuity beginning at normal retirement age.[1362] Consistent with this definition, the formula under the plan for determining the annuity payable to the participant beginning at normal retirement age (the "normal retirement annuity") is the basis for the participant's accrued benefit.

ERISA provisions

While defined contribution plans that invest in employer securities (including ESOPs), may be part of a floor-offset arrangement, ERISA generally provides that a defined benefit plan cannot invest more than 10 percent of its assets in qualifying employer securities.[1363] In 1987, ERISA was amended to clarify that the defined contribution plan in a floor-offset arrangement is treated as part of the defined benefit plan for this purpose.[1364] This clarification reflected concern that if individual accounts under a floor-offset arrangement are invested primarily or exclusively in employer securities, financial difficulties of the employer and a decline in the price of employer securities could cause the defined benefit plan to experience a funding deficiency at a time when the employer is least able to fund it, resulting in an unreasonable risk to the benefit security of the plan participants and to the PBGC.[1365]

This change had the practical effect of prohibiting floor-offset arrangements involving ESOPs or other defined contribution plans in which more than 10 percent of the combined asset values of the defined benefit plan and the defined contribution plan are invested in employer securities. However, the 1987 change applies only with respect to arrangements established after December 17, 1987.[1366] The Enron floor-offset arrangement was therefore unaffected by the provision.[1367]

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type subsidy) unless certain notice requirements are met. Sec. 4980F of the Code and sec. 204(h) of ERISA.

[1362] Sec. 411(a)(7)(A)(i) and sec. 3(23)(A) of ERISA.

[1363] ERISA sec. 407.

[1364] ERISA sec. 407(d)(3)(C) and (d)(9), as enacted by sec. 9345 of Pub. L. No. 100-203 (1987).

[1365] H.R. Rep. No. 100-391, at 116-117 (1987).

[1366] Pub. L. No. 100-203, sec. 9345(a)(3) (1987).

[1367] According to Steven Kandarian, Executive Director of the PBGC, Enron's floor-offset ESOP arrangement and those of about 150 other companies were permitted under the "grandfather" provision. Statement of Steven A. Kandarian, Executive Director, PBGC, to the Senate Finance Committee, on February 27, 2002, http://www.pbgc.gov/news/speeches/test_02_27_2002.htm.

ERISA contains general fiduciary duty standards that apply to all fiduciary actions. Among them are requirements that plan fiduciaries generally discharge their duties solely in the interest of participants and beneficiaries and with care, prudence, and diligence. A plan fiduciary that breaches any of the fiduciary responsibilities, obligations, or duties imposed by ERISA is personally liable to make good to the plan any losses to the plan resulting from such breach and to restore to the plan any profits the fiduciary has made through the use of plan assets. A plan fiduciary may be liable also for a breach of responsibility by another fiduciary in certain circumstances.

As discussed above, under a so-called safe harbor provision, fiduciaries generally are not liable for the investment decisions of plan participants in a defined contribution plan if the participants control the investment of their account.[1368] The Department of Labor has stated this safe harbor[1369] does not apply to the defined contribution plan portion of a floor-offset arrangement.[1370] Thus, the general fiduciary rules apply, even with respect to decisions made by participants.

Factual Background

The floor-offset arrangement involving Enron's Retirement Plan and the Enron ESOP was established in 1987.[1371] Under the arrangement, benefits accrued by participants under the Enron Retirement Plan for service during 1987 through 1994 generally would be offset by the equivalent annuity value[1372] of Enron stock held in one of two main subaccounts maintained for participants in the Enron ESOP as of certain determination dates, generally the date that benefit payments from the Enron Retirement Plan commence. The portion of the Enron ESOP that was used as the basis for the offset was called the "ESOP Retirement Subaccount." The computation of the offset took into account previous distributions from the Enron ESOP. If the gross annuity value of a participant's ESOP Retirement Subaccount was greater than the benefit determined

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[1368] *See* Part II.A.4., above.

[1369] *See* Part II.A.3., below.

[1370] Preamble to the final regulations under ERISA sec. 404(c), 57 Fed. Reg. 46906, 46907, n.6 (Oct. 13, 1992).

[1371] At the time, the Enron ESOP was not subject to the 10-percent limitation on investment in qualifying employer securities. Further, because the floor-offset arrangement between the Enron Retirement Plan and the Enron ESOP was established before December 1, 1987, ERISA changes limiting such arrangements, as discussed above, did not apply to it.

[1372] This is defined by the Enron Retirement Plan as the single life annuity that could be purchased under the Metropolitan Life Insurance Company Group Annuity Contract No. 9373-0 (or any successor contract) based on a specified date of implementation of the purchase of an annuity contract, a specified date of the first benefit payment under an annuity contract, and an amount of distribution from a participant's ESOP Retirement Subaccount. Sec. 20.2(a) of the Enron Retirement Plan.

under the Enron Retirement Plan benefit formula, the participant would be entitled to the excess.[1373]

In general, depending on the value of Enron stock, the amount of the offset might be greater than the value of a participant's benefit under the Enron Retirement Plan at any given time. If so, the excess in the ESOP Retirement Subaccount would have offset the participant's future benefits under the final average pay formula. If the offset amount was less than the benefit under the Enron Retirement Plan, the Enron Retirement Plan would pay the portion of the benefit that is not offset by the ESOP Retirement Subaccount.

By 1994, Enron began to consider strategies for phasing out the floor-offset arrangement.[1374] Based on the prevailing price of Enron stock, there was concern that many Enron employees would be better off if the stock in their Enron ESOP accounts were made available to them instead of remaining in the plan.[1375] According to one Enron official, because the Enron ESOP did not allow for in-service distributions from the Retirement Subaccount, some employees had left Enron in order to access the value in their Enron ESOP accounts. Giving them access to their accounts, it was thought, might mitigate this trend.[1376] An Enron executive told the Joint Committee staff that a study performed for Enron by an outside consultant showed that 97 percent of Enron employees would be better off if the Enron ESOP assets were freed up and made available to them. This reportedly made freeing up the assets under the Enron ESOP preferable to maintaining the current plan. Materials prepared for Enron's human resources personnel for responding to employee questions explain that phasing out the floor-offset arrangement would "enabl[e] [employees] to take advantage of the strong performance of Enron stock in the Enron Employee Stock Ownership Plan (ESOP) and benefit directly from any excess value in [their] ESOP Retirement Subaccount[s]."[1377]

Enron would also benefit from the change. According to the materials prepared for Enron's human resources personnel, Enron would "receive an up-front reduction in the Enron Retirement Plan's expense for 1995 because of the ESOP."[1378]

[1373] *See Enron Retirement Program Guide,* included in Appendix D to this Report.

[1374] Facsimile memorandum dated May 26, 1994, from Patrick Mackin to Carol Jewett concerning alternative strategies for phasing out the floor-offset arrangement. EVE1214712-EVE1214724.

[1375] Additionally, according to one Enron executive interviewed by Joint Committee staff some employees had left Enron in order to get access to their ESOP accounts.

[1376] *Id.*

[1377] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995), included in Appendix D to this Report. *See also, The Enron Retirement Plan & ESOP Program Guide for Former Employees*, EC000020149-EC000020166.

[1378] *Id.*

Enron officials decided to phase out the floor-offset arrangement on a gradual, five-year schedule. For each year during the period 1996 through 2000, (1) the value of 20 percent of the stock in participants' Retirement Subaccounts would be frozen permanently and used to offset participant's final average pay benefit accrued during the period 1987 through 1994 and (2) participants generally would have access to 20 percent of their vested Enron ESOP Retirement Subaccount balances.[1379]

Each January during 1996 through 2000, 20 percent of participants' ESOP Retirement Subaccount was withdrawable at their election. As discussed in detail below, participants had four options with respect to each 20 percent increment of their ESOP Retirement Subaccount released to them. For participants who chose to leave their shares in the Enron ESOP, the value of that increment was fixed. A separate offset value was calculated for each 20 percent increment of participants' Retirement Subaccounts. The closing market stock price as of January 1 of each year determined the value of the offsets, permanently fixing that component of the offset.[1380] If no sale of Enron stock occurred on such date, the closing price for the next preceding day on which a sale occurred would be used. Subsequent changes in the value of Enron stock did not change the part of the offset that had been fixed. The floor-offset arrangement is discussed in further detail below.

The concept of locking in the stock price for the offset was developed by Enron employees and executives as well as outside counsel. According to Enron's outside counsel, Enron management wanted "to take extra-ordinary efforts to find a way, if at all possible, to avoid making all of the shares in the ESOP Retirement Account available at one time."[1381] Enron officials participating in the design of the phase out told the Joint Committee staff that they were generally motivated by an orderly roll out of employees' Enron ESOP accounts. They believed that staggering the availability of employees' shares in their Retirement Subaccounts would "avoid market distortions in the trading of Enron stock...reduce the risk of fixing the offsets based on an aberrant value, and...deter participants from making precipitous decisions regarding the disposition of amounts that become distributable from their Offset Accounts."[1382] The rationale was also explained as preventing "all of the shares [from] hit[ting] the market in a

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[1379] Active employees with an ESOP Special Allocation Subaccount also had access to the vested portion of that account. In addition, employees who were active and who were at least age 50 and with at least five years of accrual service on January 1, 1995, received 100 percent access to their shares in the Retirement Subaccount in January 1996.

[1380] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995) states that the "specific day in January will probably be the closing price on the first trading day of the year." These materials are included in Appendix D to this Report.

[1381] Facsimile memorandum dated May 26, 1994, from Patrick Mackin to Carol Jewett of Vinson & Elkins, EVE1214721-EVE1214722.

[1382] Facsimile memorandum dated May 26, 1994, from Pat Mackin to Carol Jewett of Vinson & Elkins, EVE1214721-EVE1214722. *Also see* Department of Labor Advisory Opinion 94-42A (Dec. 9, 1994).

given year as this could have a negative impact on the stock price. In addition, this allows [employees] to lock in the offset at multiple points in time and continue to focus on increasing the value of Enron stock through [their] efforts."[1383]

In connection with the phasing out of the floor-offset arrangement, the Enron ESOP was frozen and the Enron Retirement Plan was continued as an independent plan.[1384] No additional shares of Enron stock were allocated to participants' ESOP Savings Subaccounts after December 31, 1994, and participants were deemed to be 100 percent vested in those accounts as of that date.[1385] Participants would vest in their Special Allocation Subaccounts over four years at a rate of 25 percent per year.[1386]

Enron ESOP participants who were actively employed by Enron on January 1, 1995, and who during such employment had both attained age 50 and completed five or more years of accrual service under the Enron Retirement Plan as of January 1, 1995, ("senior participants")

[1383] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

[1384] Enron effected a transitional benefit accrual freeze under the Retirement Plan conditioned on receipt of a favorable advisory opinion from the Department of Labor. *See* Department of Labor Adv. Op. 94-42A (Dec. 9, 1994). The freeze provided that no participant would be credited with accrual service for the 1995 plan year and any provisions of the Retirement Plan which affect accrued benefits by reason of changes pertaining to a participant's employment (including compensation changes) would not apply to affect a member's accrued benefit by reason of events occurring in 1995.

[1385] *See* Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995), included in Appendix D to this Report. Additionally, in late 1994, 1995 and 1996, small allocations were made to the accounts of existing ESOP participants. On December 31, 1994, participants received an allocation originally targeted to be five percent of their December 31, 1994, annualized base pay, adjusted for projected 1995 dividends. The actual 1994 allocation was 2.826 percent of base pay. In 1995, an additional 0.427 percent of base pay was allocated from nonvested shares forfeited by former participants. In 1996, an allocation of 0.524 percent was made. This represented the difference between the total allocation and the five percent target amount, 1.223 percent of December 31, 1994, base pay, which was to be provided as a credit under the Enron Cash Balance Plan. This allocation and the special credit to the Enron Cash Balance Plan were made in lieu of a Retirement Plan accrual for 1995. In 1996, participants in the Enron ESOP began to directly receive the dividends on shares held in their Retirement Subaccounts and Special Subaccounts, including those to which participants had not gained access, EC000021272-EC000021280. *Enron - Benefit Plans and Related Programs, Policies and Practices--Employee Stock Ownership Plan* (Dec. 14, 2001). The dividends are paid in cash on a quarterly basis to participants. *Id.*

[1386] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

could annually withdraw all of their vested interest in their ESOP Retirement Subaccounts as of that date.[1387] Beginning in January 1996, senior participants could also annually access in 20 percent increments special allocation subaccounts set up to hold special allocations made in 1994.

Also, beginning January 15, 1996, participants other than senior participants could withdraw 20 percent of (1) their ESOP Retirement Accounts and (2) the vested portions of the special allocation accounts set up to hold special allocations made in 1994.[1388] Any amount not withdrawn would be added to the future amounts available for withdrawal.[1389] Table 1 shows the schedule on which participants could withdraw shares from their accounts.

[1387] Tenth Amendment to the Enron Corp. Employee Stock Ownership Plan (Jan. 1, 1989 restatement), EC002674029. *See also* Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995). Participants electing to retire from active employment at retirement age who were 100 percent vested could withdraw their total benefit from the Enron ESOP. *Id.* The benefits of participants under the Enron Retirement/Cash Balance Plan who left Enron before retiring would also be subject to the phased out floor-offset arrangement.

[1388] The ESOP also provided that participants could withdraw (1) from their ESOP Savings Subaccounts amounts held for 24 months or more or (2) allocations of company contributions, financed stock or reversion amounts credited to their ESOP Savings Subaccount for at least 60 cumulative months, but in either case no amount in excess of the value of the vested interest in their accounts was withdrawable. ESOP section 13.1 (Jan. 1, 1999, restatement).

[1389] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995). Participants could also elect to receive a partial withdrawal and/or a partial rollover to an IRS or to the Enron Savings Plan. *Id.* However, only one such transaction could be processed each month. *Id.*

Table 1.–Amounts Available for Withdrawal under the Phase Out of the Floor-Offset Arrangement 1996-2000

Date First Withdrawable	Number of Shares of Enron Stock Becoming Withdrawable
January 15, 1996	One-fifth of total allocated shares.
January 15, 1997	An additional number of shares equal to the number of shares which became withdrawable as of January 15, 1996, plus one-fourth of the amount of any shares purchased with earnings after January 15, 1996, if any, to the extent such shares have not become previously withdrawable.
January 15, 1998	An additional number of shares equal to the number of shares which became withdrawable as of January 15, 1996, plus one-third of the amount of any shares purchased with earnings after January 15, 1996, if any, to the extent such shares have not become previously withdrawable.
January 15,1999	An additional number of shares equal to the number of shares which became withdrawable as of January 15, 1996, plus one-half of the amount of any shares purchased with earnings after January 15, 1996, if any, to the extent such shares have not become previously withdrawable.
January 15, 2000	An additional number of shares equal to the number of shares which became withdrawable as of January 15, 1996, plus all remaining shares which had have not become previously withdrawable.

For each year for which the floor-offset arrangement was phased out, the following four options were available to participants with respect to the portion of their Retirement Subaccount and Special Allocation Subaccount then accessible to them.[1390] Participants could:

[1390] *See* Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

(1) Leave it in the Enron ESOP where it would remain invested in Enron stock;[1391]

(2) Roll it over to the Enron Savings Plan where it would initially be invested in Enron stock but could be reinvested in the Enron Savings Plan's other investment options;

(3) Roll it over to an IRA; or

(4) Receive the shares of Enron stock (although partial shares were distributable in cash).[1392]

Enron communicated the phasing out of the floor-offset arrangement to employees in a variety of ways, including through Enron's employee benefits newsletter *EnSight*[1393] and special employee meetings.[1394] Enron also provided employees with statements during the second quarter of 1995 containing the estimated January 1, 1987, through December 31, 1994, accrued benefit under the Enron Retirement Plan.[1395] Employees would also receive a communication to assist them in comparing the estimated value of their ESOP Retirement Subaccounts as compared to their estimated Enron Retirement Plan accrued benefit for that time period.[1396]

Coincident with phasing out the floor-offset arrangement, Enron sought an advisory opinion from the Department of Labor. Enron wanted the Department of Labor's opinion as to whether progressively phasing out the floor-offset arrangement over a five-year period would

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[1391] If a participant elected to leave a portion of their Retirement Subaccount in the Enron ESOP at the time it first became withdrawable, the participant thereafter had rights to withdraw it or to roll it over to an IRA or the Enron Savings Plan.

[1392] *ESOP Subaccounts Summary of Options,* EC000021992; *see* Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

[1393] *EnSight* (Nov. 1994), EC000020204-EC000020211.

[1394] Memorandum dated January 11, 1995, from Phil Bazelides, Director of Enron Corporate Human Resources, to all Enron employees enclosing the *Enron Retirement Program* Guide and announcing schedule of employee meetings. EC000020294. In addition, participants were encouraged to review the International Association for Financial Planning's *Consumer Guide to Comprehensive Financial Planning*. Memorandum from Kenneth Lay and Richard Kinder to all Enron employees (July 26, 1995), EC000020144-000020146.

[1395] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

[1396] *Id.*

render the "grandfather" treatment for pre-1987 ESOPs inapplicable.[1397] The Department of Labor issued a favorable opinion on the phaseout on December 9, 1994.[1398]

Effective January 1, 1996, the final average pay benefit formula under the Enron Retirement Plan was converted to a cash balance formula and the plan was renamed the "Enron Corp. Cash Balance Plan." The phased out floor-offset arrangement was retained under the Enron Cash Balance Plan. Thus, under the Enron Cash Balance Plan, the portion of the final average pay benefit under the Enron Retirement Plan attributable to years of accrual service credited under the plan between January 1, 1987, and December 31, 1994 ("Offsetable Benefit") is offset according to the phasing out floor-offset arrangement. That is, the Offsetable Benefit is reduced (but not below zero) by reference to sum of the five separate Enron ESOP offset amounts (the total Enron ESOP Offset Amount).

An "Offsetable Amount" equal to the actuarially equivalent annuity for such 20 percent would be determined based on the market value of the 20 percent portion on the release dates. The annuity purchase values used to value the 20 percent increments were based on an interest rate of 8.5 percent.[1399]

Exhibits to the Enron Cash Balance Plan are described as the "definitive interpretations" of the floor-offset arrangement provisions.[1400] Using an example included in those exhibits, Table 2 shows how phasing out the floor-offset arrangement works for a participant who retires or is terminated having left all the stock in their ESOP Retirement Subaccount. The example includes a final average pay benefit attributable to years of service credited under the plan prior to January 1, 1987 ("Non-Offsetable Benefit").[1401]

[1397] According to Steven Kandarian, Executive Director of the PBGC, Enron's floor-offset arrangement and those of about 150 other companies were permitted under the "grandfather" provision. Statement of Steven A. Kandarian, Executive Director, PBGC, to the Senate Finance Committee, on February 27, 2002, http://www.pbgc.gov/news/speeches/test_02_27_2002.htm.

[1398] Department of Labor Adv. Op. 94-42A (Dec. 9, 1994).

[1399] Prior to the phase out of the floor-offset arrangement, annuity purchase values were determined under the Enron Retirement Plan as the single life annuity that could be purchased under the Metropolitan Life Insurance Company Group Annuity Contract No. 9373-0 (or any successor contract) based on a specified date of implementation of the purchase of an annuity contract, a specified date of the first benefit payment under an annuity contract, and an amount of distribution from a participant's ESOP Retirement Subaccount. First Amendment to Enron Corp. Cash Balance Plan (effective Jan. 1, 1996), EC000020095-EC000020100.

[1400] Enron Cash Balance Plan sec. 5.4 (effective Jan. 1, 1996). The exhibits are included in Appendix D to this Report.

[1401] In the case of participants who are eligible to begin receiving benefits before reaching normal retirement age, the benefit payable to such participants are reduced to reflect early commencement of payments in accordance with the schedule for early reduced retirement

Table 2.–Example of Benefit Calculation Under the Phased Out Floor-Offset Arrangement

Date of Birth	07/15/45
Date of Hire	09/15/84
Non-Offsetable Benefit, 12/31/94	$1,620
Offsetable Benefit, 12/31/94	$6,109
Total Final Average Pay Benefit before Offset, 12/31/94	$7,729
Enron ESOP Retirement Account Balance, 12/31/95	800 shares

History of ESOP Releases	Date of Release	# Shares Released	Share Price at Release	Market Value of Release
Release 1	01/01/1996	160	$31	$4,960
Release 2	01/01/1997	160	$34	$5,440
Release 3	01/01/1998	160	$34	$5,440
Release 4	01/01/1999	160	$37	$5,920
Release 5	01/01/2000	160	$39	$6,240

Calculation of ESOP Offset Amount	(a) Age at Release	(b) Actuarial Equiv. Annuity Factor	(c) Market Value of Release	(c)/(b) ESOP Offset Amount
Release 1	50 and 5 months	2.476355	$4,960	$2,003
Release 2	51 and 5 months	2.686845	$5,440	$2,025
Release 3	52 and 5 months	2.915227	$5,440	$1,866
Release 4	53 and 5 months	3.163021	$5,920	$1,872
Release 5	54 and 5 months	3.431878	$6,240	$1,818
Total ESOP Offset Amount = $9,584				

Calculation of Final Average Pay Benefit at Normal Retirement	(1) Non-Offsetable Benefit	(2) Offsetable Benefit	(3) Total ESOP Offset Amount
	$1,620	$6,109	$9,584
Normal Retirement Benefit = (1) + [(2) - (3), but not less than zero] = $1,620			

benefits under the Enron Cash Balance Plan. Enron Cash Balance Plan (effective Jan. 1, 1996), sec. 5.4(b).

In the example shown in Table 2, the benefit payable to the participant is comprised of an Offsetable Benefit of $6,109 and a Non-Offsetable Benefit of $1,620. The total ESOP Offset Amount is $9,584 and the normal retirement benefit payable from the Enron Cash Balance Plan is $1,620. Thus, the final average pay benefit attributable to years of accrual service credited under the Enron Retirement Plan between January 1, 1987, and December 31, 1994, is entirely offset by the Enron ESOP Offset Amount.

During 1996 to 2000, Enron stock was trading between approximately $18 and $44.[1402] At the end of 2002, Enron's stock was trading at $0.62.[1403]

IRS review

Enron's floor-offset arrangement is currently under review by the IRS. The issues under review are discussed below.

Discussion of Issues

Calculation of benefits under floor-offset arrangements generally

In a typical floor-offset arrangement, when a participant retires, the value of the participant's benefit under the defined benefit plan is determined without regard to the offset. Then, the value of the participant's defined contribution plan account is converted to an annuity starting at retirement. This amount is then offset against the benefit determined under the defined benefit plan to determine how much of the participant's benefits will be paid from each plan. The defined benefit plan provides a floor so that if, for example, there is poor investment performance in the defined contribution plan, a plan participant will receive a benefit at least equal to the benefit under the defined benefit plan.

For example, suppose a participant has earned a benefit under the defined benefit plan portion of a floor-offset arrangement (determined before the offset) equal to an annuity of $60,000 per year starting at retirement, and that the annuity equivalent of the participant's defined contribution plan account is $5,000 per year. Under the floor-offset, the participant would not receive $65,000 a year -- the combination of the two -- rather only $60,000. The $5,000 per year annuity equivalent under the defined contribution plan is subtracted from the annuity under the defined benefit plan, so the participant receives an annuity of $55,000 per year under the defined benefit plan, plus the account balance under the defined contribution plan.

[1402] Split-adjusted stock prices are as reported in the Historical Market Data Center™ from Dow Jones & Company, Inc. According to an attachment to minutes of the November 1, 2001, meeting of the Administrative Committee, the price of Enron stock ranged from $36.63 to $63.81 during 1996 to 2000. *ESOP Facts*, attachment to Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC00001855. Although it is not clear from the attachment, the Enron stock prices listed in *ESOP Facts* do not appear to reflect stock splits that occurred during this time period.

[1403] *Id.*

On the other hand, suppose the annuity equivalent of the defined contribution account was $100,000 per year for offset purposes, the participant would be entitled only to the amount in the defined contribution plan and would not receive any benefit from the defined benefit plan.

The Enron floor-offset arrangement operated in this general manner, at least until it was phased out and the value of the offset was set over the period 1996 to 2000. Issues relating to the termination of Enron floor-offset arrangement, as well as other issues raised by the arrangement, are discussed below.

"Locking in" the offset

The IRS is reviewing the floor-offset arrangement to determine if it meets applicable qualification requirements. The main issue raised is the "locking in" of the value of the offset applicable to benefits earned under the Enron Retirement Plan during 1987 to 1994. As described above, during 1996 through 2000, Enron stock traded at approximately $18 to $44. At the end of 2002, the price of Enron stock was $0.62. Thus, for example, for a participant retiring in 2002, the locked in value of the ESOP offset is far higher than the offset would be if it were computed at retirement under the original terms of the plan.

As a result of its review, the IRS informed Enron that it was intending to issue an adverse determination with respect to the floor-offset arrangement. The IRS and Enron had a conference in December 2002, regarding the proposed adverse determination. During the conference, the IRS explained to Enron that the bases for the proposed adverse determination include that the locking in of the offset violates the anticutback rule and that the locking in results in an impermissible forfeiture. Enron has until February 24, 2002, to provide any additional information or legal arguments in support of its position that the locking in of the offset meets the qualification requirements.

The effect of the resolution of this issue on plan participants may vary depending on the participant's circumstances. For example, whether the locking in of the offset caused a reduction in a participant's accrued benefit may depend on whether the participant took a distribution at the time of the locking in or left his or her account balance in the ESOP.

The final resolution of the issue is made more complicated by the bankruptcy. Enron and its creditors have an interest in the potential liability Enron might have if the offset is determined to be invalid. The interest of the creditors may affect the actions Enron takes in connection with the proposed adverse determination. For example, Enron could agree to correct the problem and make appropriate additional contributions. However, depending on the amount involved, the creditors may or may not agree with such an approach. A variety of other resolutions are also possible at this point in time.

Other issues

In addition to the locking-in, other issues may arise under the floor-offset arrangement.

Under the applicable authorities, the defined benefit plan in a floor-offset arrangement must provide definitely determinable benefits taking into account the offset.[1404] Thus, the plan must specify the interest and mortality assumptions, as well as the date as of which the determination shall be made. Plan documents reviewed by Joint Committee staff indicate that for purposes of determining the offset amount associated with a particular ESOP release, the Enron Retirement/Cash Balance Plan used the single life annuity commencing at age 65 that is actuarially equivalent to the market value of the stock released under the Enron ESOP at the date of release based on the participant's age, an 8.5 percent interest rate assumption and post-age 65 mortality assumptions under the 1984 Unisex Pension Mortality Table set back one year.[1405]

Further, under a floor-offset arrangement, only the vested benefit in the defined contribution plan may be used to offset the benefit under the defined benefit plan.[1406] Materials reviewed by Joint Committee staff show that under Enron's floor-offset arrangement, the offset amount was based on shares of Enron stock in participants' Enron ESOP Retirement Subaccounts.[1407] Any Enron ESOP participant who was actively employed by Enron as of December 31, 1994, was 100 percent vested in his Retirement Subaccount.[1408] Thus, benefits accrued under the Enron Retirement Plan were offset by vested benefits under the Enron ESOP.[1409]

Additionally, under applicable regulations, the defined contribution portion of a floor-offset arrangement must comply with qualified joint and survivor requirements even if the plan would not otherwise be subject to those requirements. Thus, the Enron ESOP may be required to offer benefits in the form of a qualified joint and survivor annuity because the portion of the benefit accrued under the final average pay formula of the Enron Retirement Plan during 1996 to 2000 may be offset by a participant's vested benefit in the Enron ESOP. In some cases, prior to the November 1996 amendment to the Enron ESOP providing that the standard form of benefit for married participants generally was a joint and survivor annuity, participants in the Enron Retirement Plan/Cash Balance Plan whose accrued benefits under the Plan were completely

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[1404] Rev. Rul. 76-259, 1976-2 C.B. 111.

[1405] Sec. 5.2(1), Enron Cash Balance Plan (Jan. 1, 2001, restatement).

[1406] *See* Rev. Rul. 76-259, 1976-2 C.B. 111.

[1407] Sec. 5.4, Enron Cash Balance Plan (Jan. 1, 2001, restatement).

[1408] The offset-arrangement applies to benefits accrued under the Enron Retirement Plan from January 1, 1987, through December 31, 1994.

[1409] Prior to the phase out of the floor-offset arrangement, in the case of a distribution prior to retirement, the offset was based on the value of the amount distributed from the ESOP, which was vested amounts.

offset by their benefit under the Enron ESOP may not have been offered a qualified joint and survivor annuity.[1410]

2. Conversion of the Enron Retirement Plan to the Enron Cash Balance Plan

During 1994, Enron considered changing the design of the Enron Retirement Plan.[1411] By the end of 1994, plans were in place to convert the benefit formula under the Enron Retirement Plan to a cash balance formula.

Present Law

Overview

As described above,[1412] a cash balance plan is a defined benefit plan with benefits resembling the benefits associated with defined contribution plans. Under a cash balance formula, the benefit is defined by reference to a hypothetical account balance, which is credited with pay credits and interest credits. Although a participant's benefit under a cash balance plan is described in terms of a hypothetical account balance, as a defined benefit plan, a cash balance plan is required to provide benefits in the form of a life annuity commencing at a participant's normal retirement age. This annuity is determined as the actuarial equivalent of the participant's account balance at normal retirement age, using interest and mortality factors specified in the plan. The annuity payable at normal retirement age serves as the basis for the participant's accrued benefit.

Cash balance plans are subject to the qualification requirements applicable to defined benefit plans generally. However, because such plans have features of both defined benefit plans and defined contributions plans, questions arise as to the proper application of the qualification requirements to such plans, particularly if a defined benefit plan with a typical benefit formula is converted to a cash balance plan formula. Issues that commonly arise include, in the case of a conversion to a cash balance plan formula, the application of the rule prohibiting a cutback in accrued benefits[1413] and the application of the age discrimination rules. These rules are discussed below. Other issues have been raised in connection with cash balance plans, including

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[1410] As described above, in Part II.B.5., in November 1996, the Enron ESOP was amended to provide that the standard form of benefit generally was a joint and survivor annuity for married participants and a single life annuity for unmarried participants. Under the 1999 restatement of the Enron ESOP, an annuity was an alternative form of benefit to the standard lump sum. The annuity form of benefit under the Enron ESOP was eliminated effective August 15, 2001.

[1411] Minutes of the Meeting of the Administrative Committee (Apr. 13, 1994), EC0000766692.

[1412] *See* Part II.A.2., above.

[1413] Sec. 411(d)(6).

the proper method for applying the accrual rules and the proper method for determining lump sum distributions.

There is little guidance under present law with respect to many of the issues raised by cash balance conversions. In 1999, the IRS imposed a moratorium on determination letters for cash balance conversions pending clarification of applicable legal requirements.[1414] Under the moratorium, all determination letter requests regarding cash balance plans are sent to the National Office for review; however, the National Office is not currently acting on these plans.[1415] As described below, the Treasury Department recently issued proposed regulations addressing certain issues relating to cash balance plans.

Under ERISA, employer decisions regarding plan design are generally considered "settler functions" that are not subject to ERISA's fiduciary rules. Implementation of plan design changes may, however, involve discretionary authority with respect to plan administration and, thus, may involve fiduciary obligations.

In addition to raising legal questions, conversions of cash balance plans in the 1990's also received considerable media attention. A major issue raised in the media was the treatment of longer-service workers, who were expected to receive greater benefits under a typical defined benefit plan than under a cash balance plan. Concerns were raised that, under certain plan designs, longer-service workers (who also tend to be older), were being treated unfairly (even if legal requirements had technically been met) upon conversion to a cash balance plan.

Protection of accrued benefits

In general

The Code generally prohibits an employer from amending a plan's benefit formula to reduce benefits that have already accrued (the "anticutback rule").[1416] For this purpose, an amendment is treated as reducing accrued benefits if it has the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy or of eliminating an optional form or benefit.[1417]

The "anticutback rule" applies in the context of cash balance plan conversions. Because of this rule, after conversion to a cash balance design, a plan still must provide employees with

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[1414] Announcement 2003-1, 2003-2 I.R.B. 281, http://www.irs.gov/pub/irs-drop/a-03-1.pdf.

[1415] *Id.*

[1416] Sec. 411(d)(6). The provisions do not, however, protect benefits that have not yet accrued but would have in the future if the plan's benefit formula had not changed.

[1417] Sec. 411(d)(6)(B).

the normal retirement benefit that he or she had accrued before the conversion.[1418] However, the plan may determine benefits for years following the conversion in a variety of ways, while still satisfying the anticutback rule. Common plan designs are discussed below.

Wearaway (or "greater of" approach)

Under a "wearaway" approach, a participant does not accrue any additional benefits after the conversion until the participant's benefits under the cash balance formula exceed their preconversion accrued benefit. Because of this effect, plans with a wearaway are also referred to as using the "greater of" method of calculating benefits. Plan design can greatly affect the length of any wearaway period.

Upon a conversion to a cash balance plan, participants are given an opening account balance. The pay and interest credits provided under the plan are then added to this opening account balance. The opening account balance may be determined in a variety of ways and is generally a question of plan design. For example, an employer may create an opening account balance that is designed to approximate the benefit a participant would have had, based on the participant's compensation and years of service, if the cash balance formula had been in effect in prior years. As another example, an employer may convert the preconversion accrued benefit into a lump sum amount and establish this amount as the opening account balance. Depending on the interest and mortality assumptions used, this lump sum amount may or may not equal the actuarial present value of the participant's accrued benefit as of the date of conversion, determined using the statutory interest and mortality assumptions required for lump sum calculations.

Under the wearaway approach, the participant's protected benefit is compared to the normal retirement benefit that is provided by the account balance (plus pay and interest credits), and the participant does not earn any new benefits until the new benefit exceeds the protected accrued benefit. For example, suppose the value of the protected accrued benefit is $40,000, and the opening account balance under the cash balance formula provides a normal retirement benefit of $35,000. The participant will not earn any new benefits until the hypothetical balance under the cash balance formula increases to the extent that it provides a normal retirement benefit exceeding $40,000.

No wearaway (or "sum of " approach)

Under a plan without a wearaway, a participant's benefit under the cash balance plan consists of the sum of (1) the benefit accrued before conversion plus (2) benefits under the cash balance formula for years of service after the conversion.[1419] This approach is more favorable to

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[1418] Certain other plan features, such as early retirement subsidies, must also be protected.

[1419] In some cases, the plan may convert the protected benefit into a lump sum equivalent for purposes of the opening account balance. Even if at the time of the initial calculation the opening balance equals the value of the protected benefit, the account balance may not continue to reflect the value of the protected benefit over time, depending on the actuarial assumptions

plan participants than the wearaway approach, because they earn benefits under the new plan formula immediately. This approach is also sometimes referred to as the "A + B" method, where A is the protected benefit and B is benefits under the cash balance formula.

Grandfathering

For older and longer-service participants, benefits under a cash balance formula tend to be lower than the benefits a participant may have expected to receive under the traditional defined benefit formula (the "old" formula).[1420] The employer might therefore provide some type of "grandfather" to participants already in the plan or to older or longer-service employees. For example, the participants might be given a choice between the old formula and the cash balance formula for future benefit accruals, or, in the case or a final average pay plan, the plan may stop crediting service under the old formula, but continue to apply post-conversion pay increases, so the employee's preconversion benefit increases with post-conversion pay increases. This approach goes beyond preserving the benefit protected by the anticutback rules.

Age discrimination

In general, the Code prohibits reductions in the benefit accrual rates (including the cessation of accruals) for defined benefit plan participants on account of attainment of any age.[1421] Attainment of any age means a participant's growing older. Similarly, the Code prohibits a defined contribution plan from ceasing allocations, or reducing the rate at which amounts are allocated to a participant's account due to attainment of any age. Parallel requirements exist in ERISA and the Age Discrimination in Employment Act ("ADEA").[1422]

These provisions do not necessarily prohibit all benefit formulas under which a reduction in accruals is correlated with participants' age in some manner. Thus, for example, a plan may limit the total amount of benefits, or may limit the years of service or participation considered in determining benefits.[1423]

In general terms, an age discrimination issue arises under cash balance plans because there is a longer time for interest credits to accrue on hypothetical contributions to the account. Thus, for example, a $1,000 hypothetical contribution made when a plan participant is age 30

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used. Thus, a cash balance plan may not rely on the cash balance formula to protect accrued benefits because it may encounter problems under the anticutback rule (depending on the actuarial assumptions used).

[1420] This is sometimes the reduction in benefits that is referred to in connection with cash balance conversions, i.e., a reduction in expected benefits, not accrued benefits.

[1421] Sec. 411(b)(1)(H).

[1422] Parallel provisions are found in ERISA sec. 204(b)(1)(H) and ADEA, 29 U.S.C. sec. 623(i).

[1423] Sec. 411(b)(1)(H)(ii).

will be worth more at normal retirement age (e.g., age 65) and thus provide a higher annuity benefit at normal retirement age than the same contribution made on behalf of an older participant closer to normal retirement age. This issue is not limited to cash balance plan conversions, but applies to cash balance plans generally. Other age discrimination issues may also arise, depending in part on plan design, e.g., whether the plan has a "wearaway" (described below).

Proposed regulations issued

On December 10, 2002, the Treasury Department issued proposed regulations relating to the application of age discrimination prohibitions to defined benefit plans, including special rules for cash balance plans.[1424] The proposed regulations permit a participant's rate of benefit accrual for a year under a cash balance benefit plan to be determined without regard to interest credits, the right to which accrued before the beginning of the year. Therefore, compliance with the prohibition on a reduction in the rate of benefit accrual on account of the attainment of any age may be tested by reference to the pay credits provided under the plan. As a result, a plan that provides all participants with the same rate of pay credit generally will not violate this prohibition.[1425] However, the converted plan must qualify as an "eligible cash balance plan." In order to be an "eligible cash balance plan," a defined benefit plan must satisfy each of the following requirements for accruals in the current plan year:

(1) The normal form of benefit is stated as an immediate payment of the balance in a hypothetical account; and

(2) At the same time the participant accrues an addition to the hypothetical account, the participant accrues the right to annual (or more frequent) future interest credits (without regard to future service) at a reasonable rate of interest that does not decrease because of the attainment of any age. These interest credits must be provided for all future periods, including after normal retirement age. An eligible cash balance plan cannot treat interest credits after normal retirement age as actuarial increases that are offset against the otherwise required accrual.

[1424] Prop. Treas. Reg. sec. 1.411(b)-2. The proposed regulations provide guidance on how to determine the rate of benefit accrual or rate of allocation. The proposed regulations also address a number of other issues, including nondiscrimination testing for cash balance plans.

[1425] This approach is consistent with the court's interpretation of the age discrimination prohibition in *Eaton v. Onan Corporation*, 117 F. Supp. 2d 812 (S.D. Ind. 2000). In that case, the court rejected plaintiffs' argument that, for purposes of this prohibition, the rate of benefit accrual under a cash balance plan for a year should be determined by reference to the increase in a participant's normal retirement benefit that results from the pay credit for the year and any related future interest credits the right to which accrues in that year (similar to the manner in which the accrual rules apply to a cash balance plan).

Additionally, the proposed regulations provide that, if the plan was converted to a cash balance plan, the conversion must be accomplished in one of two ways. Specifically, the converted plan must either:

(1) Determine each participant's benefit as not less than the sum of the participant's benefits accrued under the traditional defined benefit plan and the cash balance account (the "sum of" method); or

(2) Establish each participant's opening account balance as an amount not less than the actuarial present value of the participant's prior accrued benefit, using reasonable actuarial assumptions (the "greater of" method).[1426]

The preamble to the proposed regulations states that the regulations cannot be relied on until adopted in final form. Even if the proposed regulations are issued in final form, the preamble indicates that they will apply on a prospective basis only.

The IRS moratorium on determination letters for cash balance plans will not end before the proposed regulations are issued in final form.[1427]

Notice of a significant reduction in future benefit accruals

As a result of concerns that participants affected by conversions to cash balance plans had not received sufficient notice of the effect of the conversion, a specific notice requirement was enacted in 2001.[1428] Under present law, the plan administrator of a defined benefit plan or a money purchase pension plan must provide notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or significant reduction of an early retirement benefit for retirement-type subsidy.[1429] Details of the notice requirement are contained in Treasury regulations.[1430] An excise tax is imposed on failures to comply with the notice requirement.[1431]

[1426] Depending on the actuarial assumptions used, this amount may or may not equal the present value of a participants' protected accrued benefit, determined using statutory interest and mortality assumptions.

[1427] Announcement 2003-1, 2003-2 I.R.B. 281, http://www.irs.gov/pub/irs-drop/a-03-1.pdf.

[1428] Pub. L. No. 107-16, sec. 659(a)(1) (2001).

[1429] Sec. 4980F. There is also a comparable ERISA provision.

[1430] Treas. Reg. sec. 54.4980F-1.

[1431] Sec. 4980F. The excise tax is generally equal to $100 per day for each person with respect to whom a failure to comply occurs, subject to a maximum of $500,000 per taxable year in the case of unintentional failures.

Factual Background

Decision to convert to a cash balance formula

In 1994, Enron officials began to consider implementing a new benefit formula under the Enron Retirement Plan.[1432] The information provided to the Joint Committee staff does not contain much information regarding the reasons the Enron Retirement Plan was converted to a cash balance formula. Interviews with former Enron personnel familiar with the issue indicate that several reasons influenced the decision.

Enron envisioned its work force as increasingly mobile and consisting of "fewer full career or single career employees."[1433] It was thought that Enron's employees desired benefits which were more portable than their benefits under the Enron Retirement Plan.[1434] A cash balance formula was viewed as meeting the needs of Enron's workforce. Additionally, the new formula was described as better matching Enron's vision of future workforce benefit plans."[1435] In addition, a cash balance formula would be simpler, making it easier for employees to understand and track the value of their retirement benefit.[1436] The decision was described to employees as "an effort to align Enron's retirement program with the company's approach to business."[1437]

According to materials reviewed by Joint Committee staff, Enron's decision to convert to a cash balance formula was "not a cost savings decision."[1438] However, when the prospect of a conversion was presented to the Administrative Committee by Enron's Vice President for Human Resources, one of Enron's "benefit objectives" was described as "shared responsibility

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[1432] Minutes of meeting of Enron Corp. Retirement Plan Administrative Committee (April 20, 1994), EC00766693-EC000766710.

[1433] Presentation to Administrative Committee - *Retirement Plan - from Defined Benefit to Cash Balance*, presented at April 20, 1994, meeting of Enron Corp. Retirement Plan Administrative Committee, EC000766696-EC000766710.

[1434] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995), included in Appendix D to this Report.

[1435] Presentation to Administrative Committee - *Retirement Plan - from Defined Benefit to Cash Balance*, presented at April 20, 1994, meeting of Enron Corp. Retirement Plan Administrative Committee, EC000766696-EC000766710.

[1436] *EnSight* (Dec. 1994), EC000020204-EC000020213.

[1437] *Id.*

[1438] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995).

for cost," in a shift away from the historical "paternalistic traditional defined benefit pension plan" and toward "individual responsibility."[1439]

While converting to a cash balance formula would mean a reduction in Enron's expense for 1995, for each of the subsequent nine years, the new formula would be more expensive than the old formula and for the 10-year period going forward, the new formula would be slightly more expensive for Enron.[1440] In fact, a comparative analysis prepared by an outside consultant showed that Enron was expected to contribute more cash under the new formula than under the old formula until 2002.[1441]

Enron chose a five percent of pay cash balance formula to be competitive with other companies' retirement benefits.[1442]

Plan provisions related to conversion

As of January 1, 1996, participants in the Enron Cash Balance Plan were credited with accruals of five percent of their monthly compensation as well as interest accruals as of the last day of each calendar month starting January 1, 1997.[1443]

Under the Enron Cash Balance Plan, normal retirement benefits consist of the actuarial equivalent of a series of monthly payments for a participant's life commencing on the first day of the month coinciding with or next following the date of their retirement. Each monthly payment is equal to the sum of (1) the monthly amount of the participant's final average pay benefit (using the same formula as under the Enron Retirement Plan)[1444] and (2) the monthly payment

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[1439] *Id.*

[1440] *Id.* In a letter to the Department of Labor submitted in connection with its 1994 request for an advisory opinion, Enron's outside counsel explained that because the cash balance formula would have the effect of accelerating accruals into a participant's earlier years of employment with Enron, the effect, from a funding perspective, would be to increase the funding to the plan in the short run above that which would be required if its original formula were retained. Letter dated November 23, 1994, from Enron's outside counsel to the Department of Labor.

[1441] The comparative analysis of Enron's estimated funding obligations under the final average pay formula and the cash balance formula is included in Appendix D to this Report.

[1442] Questions and answers for use by Enron human resources personnel in responding to questions from employees (Jan. 1995), included in Appendix D to this Report.

[1443] Sec. 4 of Cash Balance Plan (effective Jan. 1, 1996).

[1444] The portion of a participant's final average pay benefit which is attributable to accruals under the plan during January 1, 1987, through December 31, 1994, are offset by their interest in their ESOP Retirement Subaccount. The offset does not apply to the benefit the participant would have received under the plan as of December 31, 1986, or to any benefit

derived by converting the participant's cash balance accrual as of the annuity starting date into a single life annuity on an actuarially equivalent basis. Thus, under the terms of the converted plan, a participant's benefit generally is the sum of the participant's benefits accrued under the traditional defined benefit plan and the cash balance account.

Additionally, the Enron Cash Balance Plan includes special provisions for participants in the Enron Retirement Plan who:

(1) as of January 1, 1995, (a) were employed by Enron; (b) had attained age 50; and (c) completed five years of service under the Enron Retirement Plan ("Transition Participants"), and

(2) who retired from Enron on or before January 1, 2002.

The special provisions were intended to provide protection for such Transition Participants against adverse affects of the conversion to the cash balance formula.[1445] According to Enron, there were approximately 790 such Transition Participants but only about 140 would be adversely affected by the conversion.[1446]

Under the special provision, the retirement benefit for Transition Participants is the normal retirement benefit as described above, with the application of some special rules. The special rules are, in general, that Transition Participants who retired by January 1, 2002, are entitled to the better of the old or the new benefit formula through the participant's last day worked.[1447] That is, benefits for Transition Participants are increased by crediting additional

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accrued under the cash balance formula. Enron Cash Balance Plan section 5.1 (Jan. 1, 2001, restatement).

[1445] Letter dated October 25, 1994, from Vinson & Elkins to the Department of Labor in support of its application for an Advisory Opinion. *See* Department of Labor Adv. Op. 94-42A (Dec. 9, 1994). Enron represented that it would amend the Retirement Plan to provide that the benefits accrued by such adversely affected participants on an after January 1, 1995, will be equal to the greater of (1) benefits under the Cash Balance formula increased by certain allocations to the ESOP or (2) benefits under the Retirement Plan's formula as in effect on December 31, 1994.

[1446] Letter dated October 25, 1994, from Enron's outside counsel to the Department of Labor in support of its application for an advisory opinion.

[1447] The Plan provided (1) that a Transition Participant's accrual service will generally be increased for the period of employment January 1, 1995, to January 1, 2002, by crediting the participant with one month of accrual service for each calendar month of employment service with Enron and (2) that a Transition Participant's final average pay will be computed on the basis of a period consisting of the sixty consecutive months of employment within the last one hundred twenty months of employment with Enron prior to January 1, 2002, which yield the highest average compensation. Additionally, a Transition Participant who becomes disabled after January 1, 1995, will be credited with full and partial years of accrual service for each

accrual service with Enron under the final average pay formula through January 1, 2002, and by considering compensation earned up to such date.[1448] The Enron Cash Balance Plan also includes a special provision for Transition Participants who terminate employment with Enron before attaining age 55.[1449]

The Enron Cash Balance Plan was amended effective November 1, 2001, to eliminate the requirement that the Transition Participant terminate employment prior to January 1, 2002, to qualify for the special provision.[1450]

Information provided to participants

The decision to convert the Enron Retirement Plan to the Enron Cash Balance Plan was communicated to participants in *EnSight*, Enron's "all-employee publication dedicated to benefits education". The November 1994 edition of *EnSight* described "the decision to change benefits [as] an effort to align Enron's retirement program with the company's approach to business." It explained that "[w]hile economics were considered, cost is not the driving factor. In fact, these enhancements will mean an increase in Enron's costs over the next decade. But as Enron continues to thrive in a culture built on change and built to respond positively to change, the company is committed to retirement benefits that are: Fair...Portable...Simple...and Valuable."[1451]

Enron also described the conversion to participants in the *Enron Retirement Program Guide*.[1452] The *Program Guide* includes an example that estimates a participant's benefit under the Enron Cash Balance Plan.[1453] Materials reviewed by Joint Committee staff do not contain an example provided to participants of the special provision for Transition Participants.

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period between January 1, 1995, and January 1, 2002, during which the participant was disabled. Enron Cash Balance Plan sec. 13.2 (effective Jan 1, 1996).

[1448] Exhibit V to the Enron Cash Balance Plan is an example of the calculation of regular and transition benefits under the Plan. The exhibit is included in Appendix D to this Report.

[1449] Enron Cash Balance Plan sec. 13.2(a) (Jan. 1, 2001, restatement).

[1450] Fifth Amendment to Enron Corp. Cash Balance Plan (effective Jan. 1, 1996).

[1451] *EnSight*, November 1994, EC000020206.

[1452] *Enron Retirement Program Guide,* included in Appendix D to this Report.

[1453] *Id.*

IRS technical advice pending

An IRS examination of the Enron Cash Balance Plan's 1996 year resulted in a request by IRS examiners for technical advice from the IRS National Office.[1454] The technical advice raised the concern that as a result of the floor-offset arrangement, in some instances, the final average pay benefit was completely offset so that participants are offered no qualified joint and survivor annuity, notwithstanding Code requirements that benefits accrued under the final average pay formula be offered in the form of a qualified joint and survivor annuity.[1455] IRS examiners also asked the IRS National Office to review the effect of the conversion of the Enron Retirement Plan to a cash balance formula, in accordance with the September 15, 1999, directive that all open cases involving conversions of defined benefit plans to cash balance plans be submitted for review by the National Office.[1456]

The request arrived in National Office of the IRS on March 17, 2000, and is currently under review. On April 12, 2000, Enron submitted to the IRS a request for a determination of the tax-qualified status of the Enron Cash Balance Plan.[1457] The IRS notified Enron that its request for a determination letter would be associated with the request for technical advice from IRS examiners. The request is currently pending.

Discussion of Issues

Changes in retirement plan design, including significant changes in benefit structure and formulas, are not uncommon. Plan design changes can occur for a variety of reasons, including employer cost considerations, employer views regarding appropriate retirement benefits, the popularity of an alternative plan design among employees, and mergers of plans with disparate provisions due to corporate transactions. The timing of any particular plan design changes may also depend on a variety of factors, including administrative convenience to the employer and others involved in the change.

During the 1990s, conversions of typical defined benefit plans to cash balance formulas were common among mid- to large-size employers. There was considerable media attention regarding such conversions, particularly in cases in which the plan contained a "wearaway" or in which older or longer-service employees close to retirement were denied the opportunity to

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[1454] The advice requested from the IRS National Office concerned a technical issue that arose with respect to the examination of the Enron Cash Balance Plan, as described in Part II.B.6.

[1455] At the time the technical advice was requested, the Enron Corp. ESOP did not offer benefits in the form of a joint and survivor annuity.

[1456] Announcement 2003-1, 2003-2 I.R.B. 281, http://www.irs.gov/pub/irs-drop/a-03-1.pdf

[1457] As described above at Part II.B.6., an application for determination of the tax-qualified status of the Enron Cash Balance Plan was also submitted on February 15, 2002.

continue to accrue benefits under the old plan formula.[1458] While perhaps complying with the law, such plan designs were viewed by many as unfair to certain participants. There was concern that some employers were adversely affecting participants in order to reduce costs. There was also concern that participants might not understand the effect of the conversion on their benefits (including future benefits the participant may have accrued under the old formula).[1459]

The conversion to a cash balance plan may be motivated by a variety of factors. From the employer's perspective, the change may result in reduced pension costs. Because the level of contributions and earnings under a cash balance plan are predetermined, a cash balance plan may also make it easier for employers to manage pension liabilities. Some employers are concerned about the level of contributions that may be required to fund typical defined benefit plans and cash balance plans can provide an attractive alternative.

Cash balance plans may also have advantages for employees. Unlike typical defined benefit plans, which tend to benefit long-service participants who remain with a company until retirement, cash balance plans often benefit shorter service, more mobile workers. Thus, cash balance plans may be popular in industries or markets in which workers are relatively mobile or among groups of workers who go in and out of the workforce. Cash balance plans also provide a more portable benefit than the typical defined benefit plan. Some participants also find cash balance plans easier to understand than a typical defined benefit plan--their benefit statement shows an account balance.

In Enron's case, the conversion to a cash balance formula appeared to be motivated primarily by a desire to provide a more attractive plan for most of its workers. Enron executives viewed the future of the Enron as consisting of a highly trained, mobile workforce. In many cases, such workers would find a cash balance plan more attractive that in a typical defined benefit plan. In addition, converting to a cash balance plan was consistent with Enron's image as an innovator; at the time, cash balance plans were viewed as an emerging, new type of benefit plan. While Enron benefit costs may be reduced due to the conversion over time, materials prepared by Enron indicate that, at least initially, the conversion would result in increased pension costs.

In effecting the conversion, Enron did not adopt the plan design features that garnered most of the media attention. Enron did not adopt a wearaway, but rather used a "sum of" approach in protecting accrued benefits. In addition, Enron took steps to protect the expectations of workers who were nearing retirement by providing that they would, in effect, receive benefits under whichever formula gave the greatest benefit.

[1458] *See, e.g.*, Albert B. Crenshaw, *Companies Embrace New Pension Plan*, THE WASHINGTON POST, Jan. 31, 1999, at H1; Richard A. Oppel, Jr., *Companies Cash in on New Pension Plan; But Older Workers Can Face Penalties*, N.Y. TIMES, Aug. 20, 1999, at C1; Ellen E. Schultz & Elizabeth MacDonald, *Retirement Wrinkle: Employers Win Big with a Pension Shift; Employees Often Lose*, WALL ST. J., Dec. 4, 1998, at A1.

[1459] As mentioned above, these concerns led to the enactment of the present-law notice requirements regarding future reductions in benefit accruals. Sec. 4980F.

Enron's cash balance plan is under review by the IRS National Office pursuant to the IRS directive regarding cash balance plan conversions. The Plan has been pending in the National Office since March 2000. The Enron Cash Balance Plan conversion does not appear to raise any issues other than those that generally arise with respect to such plans, particularly in the absence of definitive guidance with respect to such issues. As mentioned above, given the Enron plan design, the Enron conversion may raise fewer issues than many cash balance conversions.

Recommendations

Present law is not clear with respect to many issues that may be raised under cash balance plans. During the 1990s when conversions were receiving considerable attention, there was significant debate in Congress and elsewhere as to whether cash balance plans should be permitted as a plan design and, if so, what rules should apply (e.g., whether the wearaway approach should be permitted). While some thought that strict limits should be placed on such plans, others were concerned that strict limits would have a harmful effect on the voluntary retirement plan system. Under present law, employers are not required to adopt qualified plans for employees, and whenever new restrictions on plan design or other aspects of plan operation are considered, there is generally an issue of whether the changes will cause employers to reduce or eliminate qualified plan benefits. Thus, in the retirement plan area, there is often a tension between providing adequate safeguards for employees and allowing employers freedom to adopt the type of plan they deem appropriate.

Under the current state of the law with respect to cash balance plans, including the proposed Treasury regulations, cash balance plan conversions will be permitted, subject to certain requirements, unless statutory changes are made. While the proposed regulations answer certain questions regarding cash balance plans, there are other issues still outstanding.

The Joint Committee staff believes that both employers and employees would benefit from certainty in the law regarding cash balance plans and that the Congress or the Treasury Department should adopt appropriate rules. Thus, the Joint Committee staff recommends that specific rules be provided with respect to cash balance plan conversions and cash balance plans generally.

3. Enron ESOP Investment in Enron Stock

Present Law

ESOPs are defined contributions plans which are designed to invest primarily in qualifying employer securities. This generally refers to securities issued by the employer sponsoring the ESOP. Like other investments in securities, benefits under ESOPs are subject to the risks inherent in investing.

ERISA imposes broad duties governing all plan fiduciaries. Among them are the requirements that plan fiduciaries discharge their duties with respect to plans solely in the interest of plan participants and beneficiaries for the exclusive purpose of providing benefits and that such fiduciaries act with reasonable care, skill, prudence, and diligence under the circumstances. A fiduciary must also diversify plan investments so as to minimize the risk of

large losses unless, under the circumstances, it is clearly not prudent to do so.[1460] Under ERISA, fiduciaries must also refrain from engaging in prohibited transactions.

Fiduciaries of ESOPs, like fiduciaries of other retirement plans subject to ERISA, are subject to ERISA's broad fiduciary duties.[1461] However, ESOP fiduciaries are generally not subject to the ERISA rule that plan investments must be diversified so as to minimize the risk of large losses.[1462] Specifically, under an ESOP, the diversification requirement and the prudence requirement (only to the extent that it requires diversification) is not violated by acquisition or holding of qualifying employer securities.[1463]

Notwithstanding, participants in ESOPs have challenged the actions of ESOP fiduciaries for failure to diversify ESOP investments. Courts have attempted to delineate the duties of ESOP fiduciaries under ERISA while remaining mindful of the purposes of ESOPs. In some instances, courts have acknowledged that ERISA's strict fiduciary standards could override plan provisions directing the investment of ESOPs in employer securities.[1464]

The difficulty of determining the ERISA responsibilities of ESOP fiduciaries has been acknowledged by courts facing this issue.[1465] In part, the difficulty arises, according to one court, because ESOPs are basically trusts created to invest in the stock of a single company.[1466]

[1460] ERISA sec. 404(a)(1)(C).

[1461] *See, e.g., Donovan v. Cunningham,* 716 F.2d 1455, 1467 (5th Cir. 1983); *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir. 1995); *Moench v. Robertson*, 62 F.3d 553, 566 (3d Cir. 1995); *Eaves v. Penn,* 587 F.2d 453, 459-60 (10th Cir. 1978).

[1462] *See* ERISA sec. 404(a)(2)

[1463] ERISA sec. 404(a)(2).

[1464] *See, e.g., Moench v. Robertson*, 62 F.3d 553, 556 (3d Cir. 1995) (The court said "[I]n limited circumstances, ESOP fiduciaries can [breach ERISA's fiduciary duty requirements] for continuing to invest in employer stock according to the plan's direction." In *Moench,* the court vacated the district court's grant of summary judgment in favor of defendant, ESOP fiduciaries, and remanded the case. The court concluded that in limited circumstances, ESOP fiduciaries could be liable under the ERISA for continuing to invest in employer securities according to the plan's direction. Ultimately, the parties reached a settlement agreement which was approved by the court.) *Moench v. Robertson,* 1996 U.S. Dist. LEXIS 21898 (D.N.J. 1996). *Also see Kuper v. Iovenko*, 66 F.3d 1447, 1458 (6th Cir. 1995).

[1465] *See Moench v. Roberston,* 62 F.3d at 569 (noting the difficulty in "delineating the responsibilities of ESOP trustees."); *Kuper v. Iovenko*, 66 F.3d at 1458.

[1466] *Id.* at 568-69.

Nonetheless, there may be a point at which investments in employer securities no longer are justified under the purposes of the trust.[1467]

In cases dealing with the ERISA-imposed duties of ESOP fiduciaries, courts have recognized that because ESOPs are generally designed to invest primarily in the stock of the employer, "an ESOP fiduciary who invests the assets in employer stock is entitled to a presumption that it acted consistently with ERISA by virtue of that decision."[1468] That presumption does not, however, foreclose review of the actions of ESOP fiduciaries.[1469] While an ESOP fiduciary may be released from certain per se violations on investments in employer securities, ERISA requires that in making an investment decision of whether or not to invest a plan's assets in employer securities, an ESOP fiduciary is governed by ERISA's "solely in interest" and "prudence" tests.[1470]

Under ERISA, directed trustees may also have fiduciary responsibility for ESOP investments in certain limited circumstances.[1471] Generally, a directed trustee is a person who has custody of the plan assets but is not charged with discretionary authority over the disposition or management of those assets. Usually, a directed trustee follows instructions of a plan fiduciary with discretion over plan assets. A directed trustee's liability for a fiduciary breach generally is limited because the directed trustee lacks the requisite authority over the plan or its assets. Nonetheless, if a directed trustee has actual knowledge of the named fiduciary's breach

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[1467] *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir. 1995) (The court said that a plan provision that completely prohibits diversification of ESOP investments violates ERISA. Accordingly, fiduciaries who continue to invest in employer securities even when the plan sponsor's value is declining should not rely on ERISA's requirement that fiduciaries discharge their duties in accordance with plan provisions that are not inconsistent with ERISA for protection. ERISA exempts ESOPs from its diversification requirements but the purpose of an ESOP "cannot override ERISA's goal of ensuring the proper management and soundness of employee benefit plans" imposed by ERISA's prudence and loyalty standards).

[1468] *Moench v. Robertson,* 62 F.3d 553.

[1469] *See, e.g., Kuper v. Iovenko*, 66 F.3d 1447 (The court said that a proper balance between the purpose of ERISA and the nature of ESOPs requires review of an ESOP fiduciary's decision to invest in employer securities for an abuse of discretion.); *also see In re McKesson HBOC, Inc. ERISA Litigation,* 2002 U.S. Dist. LEXIS 19473 (N.D. Cal. 2002) (The court said that while fiduciaries of ESOPs "may not blindly follow an ESOP plan's directive to invest in company stock," the plaintiffs needed to establish that the fiduciaries of the ESOP abused their discretion in permitting a high level of investment in employer securities.)

[1470] *See Eaves v. Penn,* 587 F.2d 453, 459 (10th Cir. 1978).

[1471] *See FirstTier Bank v. Zeller*, 16 F.3d 907 (8th Cir. 1994). *See also* 29 CFR sec. 2509.75-8, FR-14.

of fiduciary duty, the directed trustee may have a duty to determine that the instructions it receives and carries out are proper.[1472]

Factual Background

The terms of the Enron ESOP provide that each year, Enron will contribute directly to the trustee for the Enron ESOP the amount, if any, authorized by Enron's Board of Directors. Enron's contributions to the Enron ESOP were payable in cash or in shares of Enron stock, as determined by the Board. To date, Enron has never made a direct contribution to the Enron ESOP.[1473]

Participants in the Enron ESOP were neither required nor permitted to make contributions to the Enron ESOP.

The Enron ESOP provides that plan assets are to be invested primarily in shares of Enron stock. For purposes of complying with the Code requirement that such assets are invested "primarily" in shares of such stock, the Enron ESOP provides that plan assets will be deemed to be so invested if 80 percent or more of the aggregate plan assets are invested in Enron stock. However, plan assets attributable to Enron stock which was purchased with the proceeds of the reversion transferred to the Enron ESOP when it was created in 1986 must be 100 percent invested in Enron stock to qualify for the exception to the excise tax on reversions.

The Enron ESOP provides that the duties, obligations, and responsibilities of the Enron ESOP trustee are governed by the trust agreement. The trust article entitled "Investment of Trust Fund" provides that the named fiduciary under the Enron ESOP has all discretionary authority for the management and control of the trust fund and is responsible for determining the diversification policy and for monitoring adherence by the investment manager to such policy. Under the trust agreement, the named fiduciary generally is the plan administrator, in this case, the Administrative Committee.

Materials presented by Enron's ERISA counsel to members of the Administrative Committee at the March 9, 2000, meeting generally describe the Administrative Committee's trustee duties. For example, the materials explain the general rules pertaining to appointment, removal and replacement of the plan trustee and the payment of plan expenses. In a section on the Enron ESOP's special provisions, the materials state that the trustee may invest up to 100 percent of the trust in Enron stock but that the Administrative Committee determines the extent to which the trust fund will be invested in Enron stock and determines the price at which the stock will be bought or sold.[1474]

[1472] *See FirstTier Bank v. Zeller*, 16 F.3d 907 (8th Cir. 1994), *Ershick v. United Missouri Bank of Kansas City*, 948 F.2d 660 (10th Cir. 1991), *Newton v. Van Otterloo*, 756 F. Supp. 1121 (N.D. Ind. 1991).

[1473] The assets of the ESOP are attributable to the stock purchased with the 1986 loan and 1987 reversion.

[1474] These materials are included in Appendix D to this Report.

As discussed above,[1475] the Administrative Committee generally did not evaluate Enron stock as an appropriate investment under the Enron ESOP. As described by one Administrative Committee member, the Enron ESOP plan terms provided for investment of plan assets in Enron stock, so there was no need to review that investment. The Administrative Committee questioned for the first time whether it should be examining Enron stock as an investment under any of the Enron qualified plans on November 1, 2001.[1476]

Documents provided by Enron indicate that, due to the volatility of Enron's stock and the fiduciary responsibility of the Administrative Committee, a special meeting of the Administrative Committee was held on November 1, 2001, to discuss the prudent steps that the Administrative Committee might need to consider with respect to the Enron Savings Plan, as well as other Enron qualified plans.

The Administrative Committee was presented with a snapshot of the current Enron stock holdings in the Enron Savings Plan and Enron ESOP as of October 26, September 30, and January 1, 2001. The Administrative Committee was advised that it had no duty to issue cautionary advice on the value or risk of holding Enron stock because the Administrative Committee does not act in the capacity of an investment advisor, but is charged with administering the plans in accordance with the terms of the plan documents and in compliance with ERISA. It was decided that the Administrative Committee should hire an independent investment advisor to monitor Enron stock, and a member of Enron's treasury department was directed to conduct the search.

With respect to the Enron ESOP, it was determined that the Administrative Committee had no duty to take action since adequate communication has been given to participants over the years. The Administrative Committee would review the recommendations of the investment advisor as to what, if any, action might be required.

Table 3 shows the number of active, retired, or separated participants with account balances and the number of beneficiaries of deceased participants entitled to benefits under the Enron ESOP during the period 1990 to 2000.[1477] Additionally, it shows how many shares were held by the Enron ESOP and the total value of the Enron ESOP assets during each year of the period. At the end of 2000, the total value of the ESOP assets exceeded $1 billion. As a result of the bankruptcy, the value of the ESOP assets was minimal.

[1475] Part II. B.3.

[1476] Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001847.

[1477] 1990 was the first year for which Joint Committee staff reviewed data.

Table 3.–The Enron ESOP–Number of Participants, and Shares Held and Total Value of Assets

Year	Number of Active, Retired, or Separated Participants with Account Balances or Beneficiaries of Deceased Participants Entitled to Benefits at End of Year	Shares of Enron Stock at End of Year (millions)	Total Value of ESOP Assets at End of Year (millions of dollars)
1990	9,396	17.2	469.2
1991	10,111	25.6	602.4
1992	10,664	33.8	788.0
1993	11,463	49.6	952.7
1994	11,262	32.5	827.6
1995	11,172	20.1*	797.1
1996	11,056	36.9*	689.9
1997	10,826	29.5	562.8
1998	10,585	**	624.6
1999	8,209	18.1	807.3
2000	6,920	12.8	1,062.9

Source: Forms 5500 for the Enron ESOP for the applicable years, unless otherwise indicated.
*Source: *Tittle v. Enron Corp.*, S.D. Texas, No. H-01-3913, First Consolidated and Amended Complaint (filed April 8, 2002), at paragraphs 173-174.
**No data available.

Discussion of Issues

The precipitous decline in the value of Enron stock raises the question of whether, at some point, plan fiduciaries have an obligation to question whether employer securities is an appropriate investment for a plan despite plan provisions directing such investment. As noted above, courts have sometimes found this issue to be difficult, because ERISA's general fiduciary standards and the policies underlying the present-law rules relating to employer securities have some inherent conflict. The questions raised in this regard in the case of the Enron ESOP are similar to those raised in other cases in which this issue has arisen.

These issues may include questions of law as well as fact, including: who are the relevant plan fiduciaries and what were their respective roles under the terms of the Enron ESOP and the related trust; the specific terms of the Enron ESOP and trust regarding investment authority and the types of investments that could be made; and at what point fiduciaries should have acted. These issues are being addressed in litigation. A discussion of the Enron ESOP and the relevant law has been provided here in order to provide a more complete picture of Enron qualified plans.

In addition to the issues raised specifically with respect to the Enron ESOP, the overall structure of Enron's qualified plans raises issues regarding appropriate levels of diversification in retirement plans, and ways to achieve such levels. These issues are addressed in Part II.C.5., below.

4. Change of recordkeepers under the Enron Savings Plan

Present Law

In general

The selection and change of third party service providers to qualified retirement plans are subject to ERISA's general fiduciary provisions.[1478] At the time of the Enron bankruptcy, there were no specific rules addressing blackout periods, so the general fiduciary rules were the only governing provisions. Advance notice of blackouts with respect to plans, i.e., periods during which participants are unable to engage in certain transactions due to a change in recordkeepers or other reasons, is now required under the Sarbanes-Oxley Act of 2002.[1479] These specific notice provisions now apply in addition to the general fiduciary rules. Even though the notice requirement did not apply at the time of the Enron blackout, a description is provided here for completeness.

In addition to the notice requirement, the Sarbanes-Oxley Act also included a provision prohibiting a director or executive officer of a publicly traded corporation from trading in the stock of the employer during a blackout period in certain circumstances.[1480]

Notice of blackout periods under the Sarbanes-Oxley Act

In general

The Sarbanes-Oxley Act amended ERISA to require the plan administrator of an individual account plan[1481] to provide advance notice of a blackout period (a "blackout notice") to plan participants and beneficiaries to whom the blackout period applies.[1482] Generally, notice must be provided at least 30 days before the beginning of the blackout period. In the case of a blackout period that applies with respect to employer securities, the plan administrator must also provide timely notice of the blackout period to the employer (or the affiliate of the employer that issued the securities, if applicable).

Definition of blackout period

A blackout period means any period during which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of the plan, to direct or

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[1478] These provisions are discussed in Part II.A.4., above.

[1479] Pub. L. No. 107-204, enacted July 30, 2002.

[1480] *Id.* at sec. 306(a).

[1481] An "individual account plan" is the term generally used under ERISA for a defined contribution plan. The notice requirement does not apply to one-participant plans.

[1482] ERISA sec. 101(i), as enacted by section 306(b) of the Sarbanes-Oxley Act of 2002.

diversify assets credited to their accounts, or to obtain loans or distributions from the plan, is temporarily suspended, limited, or restricted if the suspension, limitation, or restriction is for any period of more than three consecutive business days. However, a blackout period does not include a suspension, limitation, or restriction that (1) occurs by reason of the application of securities laws, (2) is a change to the plan providing for a regularly scheduled suspension, limitation, or restriction that is disclosed through a summary of material modifications to the plan or materials describing specific investment options under the plan, or changes thereto, or (3) applies only to one or more individuals, each of whom is a participant, alternate payee, or other beneficiary, under a qualified domestic relations order.

Timing of notice

Notice of a blackout period is generally required at least 30 days before the beginning of the period. The 30-day notice requirement does not apply if (1) deferral of the blackout period would violate the fiduciary duty requirements of ERISA and a plan fiduciary so determines in writing, or (2) the inability to provide the 30-day advance notice is due to events that were unforeseeable or circumstances beyond the reasonable control of the plan administrator and a plan fiduciary so determines in writing. In those cases, notice must be provided as soon as reasonably practicable under the circumstances unless notice in advance of the termination of the blackout period is impracticable.

Another exception to the 30-day period applies in the case of a blackout period that applies only to one or more participants or beneficiaries in connection with a merger, acquisition, divestiture, or similar transaction involving the plan or the employer and that occurs solely in connection with becoming or ceasing to be a participant or beneficiary under the plan by reason of the merger, acquisition, divestiture, or similar transaction. Under the exception, the blackout notice requirement is treated as met if notice is provided to the participants or beneficiaries to whom the blackout period applies as soon as reasonably practicable.

The Secretary of Labor may provide additional exceptions to the notice requirement that the Secretary determines are in the interests of participants and beneficiaries.

Form and content of notice

A blackout notice must be written in a manner calculated to be understood by the average plan participant and must include (1) the reasons for the blackout period, (2) an identification of the investments and other rights affected, (3) the expected beginning date and length of the blackout period, and (4) in the case of a blackout period affecting investments, a statement that the participant or beneficiary should evaluate the appropriateness of current investment decisions in light of the inability to direct or diversify assets during the blackout period, and (5) other matters as required by regulations. If the expected beginning date or length of the blackout period changes after notice has been provided, the plan administrator must provide notice of the change (and specify any material change in other matters related to the blackout) to affected participants and beneficiaries as soon as reasonably practicable.

Notices provided in connection with a blackout period (or changes thereto) must be provided in writing and may be delivered in electronic or other form to the extent that the form is

reasonably accessible to the recipient. The Secretary of Labor is required to issue guidance regarding the notice requirement and a model blackout notice.

Penalty for failure to provide notice

In the case of a failure to provide notice of a blackout period, the Secretary of Labor may assess a civil penalty against a plan administrator of up to $100 per day for each failure to provide a blackout notice. For this purpose, each violation with respect to a single participant or beneficiary is treated as a separate violation.

Factual Background

In 2001, Enron Corp. changed recordkeepers under the Enron Savings Plan from Northern Trust Retirement Consulting ("Northern Trust") to Hewitt Associates ("Hewitt"). As part of this change, there was a period of approximately 2-½ weeks during which plan participants could not make investment changes (the "blackout"). During the blackout, the price of Enron stock fell.

Background--prior recordkeeper searches[1483]

During the period which was the subject of the Joint Committee staff review, Enron undertook a number of searches for new third party service providers for various benefit plans, including the Enron Retirement Plan, the Enron Savings Plan, and health and welfare benefit plans (i.e., plans other than retirement plans). In some, but not all cases, these searches resulted in a change of recordkeeper. Some of these searches related to efforts by Enron to outsource more of its benefit plan administration. For example, the Enron Retirement Plan had been administered in-house and was outsourced in 2000. Enron also looked for new third party service providers with respect to all its benefit plans, in 2000, including pension and welfare plans, but decided not to change recordkeepers for the Enron Savings Plan at that time.

With respect to the Enron Savings Plan specifically, a new recordkeeper search was begun in 1998 as a result of the acquisition by Enron of Portland General Electric ("PGE") in 1997. PGE also had a 401(k) plan, and Enron wanted to merge the two plans. While similar in many respects, the two plans had a number of differences. For example, the PGE match was at a higher level than the match in the Enron Savings Plan; the Enron Savings Plan had daily valuations, whereas PGE had monthly valuations. Many other plan features also varied.

The plans also had different recordkeepers. The Enron Savings Plan had Northern Trust Retirement Consulting ("Northern Trust") as recordkeeper, and the PGE plan recordkeeper was

[1483] Background information relating to prior searches for recordkeepers is based primarily on documents provided by Enron in response to the Joint Committee staff requests for information. Documents relating to prior recordkeepers encompasses almost an entire box of information. Relevant document numbers include a range of documents from EC000022700-23700. Information was also obtained from minutes of Administrative Committee meetings, interviews with Enron employees, and the Timeline Presented to the Administrative Committee (EC000001909-16), which is included in Appendix D to this Report.

Towers Perrin. While merging the two plans did not necessarily require hiring a new recordkeeper, in mid-1998, Enron engaged Watson Wyatt Worldwide ("Watson Wyatt") to assist in the search for a new recordkeeper. A letter to Enron from Watson Wyatt regarding the search process states the understanding that Enron was not at that time dissatisfied with the services being provided by Northern Trust, but would like to "test the waters" to see what other options might be available for the combined Enron/PGE plan.[1484] At that time, Enron records indicate the goal was to have the search completed by October 31, 1998, with a proposed implementation date of July 1, 1999.

According to documents provided by Enron, requests for information were sent out to 33 vendors in July 1998. The requests for information sought responses to a variety of questions relevant to the plans, such as the ability to perform daily valuations and administer self-directed accounts. Enron received responses from 17 vendors (10 of whom declined to provide service if assets did not change to their respective funds), seven vendors declined to participate, and nine vendors did not respond. Watson Wyatt compiled the responses and provided analysis and evaluations to Enron.

During the next few months, requests for proposals were sent to a number of vendors, with follow-up questions in some cases. Watson Wyatt again compiled and analyzed the responses in a number of areas. A weighted quantitative evaluation of the responses was provided. This process led to site visits by Enron to the top two candidates Fidelity Institutional Retirement Services Company ("Fidelity")--Fidelity and Northern Trust. Documents provided by Enron indicate that the decision to hire Fidelity was made at the end of October 1998. However, as described in more detail below, it was then decided to postpone any change in recordkeepers until after the merger of the two plans.

The merger of the plans went forward starting in June 1999. The merger resulted in a blackout period for PGE plan participants that was expect to last about 8-12 weeks, during the period from June 15 through September 3. Documents provided by Enron indicate there was a trust reconciliation issue that caused the blackout period to extend until September 15, 1999. Plan participants were apparently notified of the change in the blackout period by mail. Enron plan participants also had a blackout period that lasted from August 30, 1999, to September 3, 1999, even though they did not have a trustee or recordkeeper change. The blackout was said to be necessary in order to complete the merger of the approximately 3,400 PGE participants into the plan.

The involvement of the Enron Savings Plan Administrative Committee in the search for the new recordkeeper and the merger of the two plans is unclear. The first reference to the merger appears in the Administrative Committee meeting minutes of September 17, 1998, wherein it was reported that a member of the Enron Benefits Department updated the Administrative Committee on the work being done by the Enron and PGE Human Resources and Treasury Departments relating to the merger of the two plans. At that time, a joint meeting of

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[1484] Enron Corp. Service Provider Vendor Search RFI Teleconference notes prepared by Watson Wyatt, EC000022724-27.

the Administrative Committees of both plans on savings plan issues was scheduled for November 11, 1998.

According to Enron, there are no minutes of Enron Savings Plan Administrative Committee meetings from October 19, 1998, through October 26, 1999. However, a document prepared by Enron employees and provided to the Administrative Committee in connection with the recordkeeper search in 2001, indicates that the Administrative Committee was briefed on the transition on November 4, 1998. This document says that in November 1998, the "[d]ecision [to change recordkeepers] was reviewed for impact to Non-Qualified Deferral (NQ) Plans wherein it was determined that the recent vendor change for the NQ plans was to go live 3/99 at Northern Trust. A new recommendation was made to not move the 401(k) recordkeeping until after the PGE plan merger and [Enron's] Qualified and Non-Qualified plans were stabilized." The document also says that on November 4, 1998, "Presentations were given to both the PGE and [Enron's] administrative committees notifying both of the recommendation. In subsequent meetings, the recommendation to stay with Northern Trust was approved until the plans were stable. At this point, there was no more work on the move away from Northern Trust until after the PGE plan had been merged."[1485]

Documents provided by Enron to the Joint Committee staff include a document dated November 1998 titled: "Presentation to the Administrative Committees: The 1999 Enron/Portland General Savings Plan." This document includes a schedule of events, which indicates that in November 1998 there would be "presentation to the Committees for approval." The document also includes information relating to differences between the two plans, background on the recordkeeping search (including a list of possible service providers and their rankings based on responses to requests for information), the recommendation to hire Fidelity and background information regarding why, fee comparison information, discussion of adding a self-directed account, and implementation issues. It is unclear whether this document was presented to the Administrative Committee. Despite the fact that Administrative Committee minutes do not reflect discussion of this process, one committee member interviewed by the Joint Committee staff described the merger process as one of two major events that occurred during his tenure on the Administrative Committee.

2001 search process

Reasons for looking for new recordkeeper

Enron personnel and records indicate that the search for a new recordkeeper stemmed from customer service issues with respect to the prior recordkeeper (Northern Trust), such as difficulty dealing with the number of employees and transactions and data issues with respect to government filings. Enron personnel also felt that the level of technology services provided by Northern Trust in connection with the Savings Plan was not sufficient to satisfy the demands of Enron employees. Northern Trust personnel have testified regarding Enron comments on customer service issues and stated that Northern Trust had been working with Enron to correct

[1485] Timeline Prepared for Administrative Committee, EC000001869-EC000001875. This document is included on Appendix D to this Report.

identified problems, such as responses to telephone inquiries, and that progress in correcting problems had been made. Northern Trust personnel also testified to their understanding that Enron prided itself on its own technology and that Enron felt that the Northern Trust trading desk was not as advanced as the Hewitt operations.[1486] Enron personnel told the Joint Committee staff that although they had been working with Northern Trust to correct problems, they eventually determined that it would be appropriate to look for a change of recordkeepers.

Selection process for new recordkeeper (Enron stock price: $78.79 on February 1, 2001; $68.68 on March 1, 2001; $56.57 on April 2, 2001; $63.41 on May 1, 2001)

Enron employees told the Joint Committee staff that Enron had a task force consisting of four to five employees involved in the process of engaging a new recordkeeper for the Enron Savings Plan. While much of the detail work was handled by a single person, Enron personnel have stated that the decision-making process was a joint process. At the same time, Enron was also interested in a new recordkeeper with respect to the 1994 Deferral Plan and Expat Deferral Plan. According to Enron personnel, they had been experiencing customer service issues with respect to the 1994 Deferral Plan for some time. However, the volume of business generated by that plan was low so that most companies were not willing to bid for that plan alone, they would bid only in conjunction with a larger plan such as the Enron Savings Plan. When a decision was made to go forward with a change in recordkeepers for the Enron Savings Plan, personnel responsible for the 1994 Deferral Plan and Expat Plan were also involved and the search was a joint search.[1487]

As they had before, Enron engaged Watson Wyatt to assist in the search process and to update the work from the earlier searches. The search process began in early 2001.[1488] Watson Wyatt did a research screening of at least six companies, including Northern Trust and Hewitt. As part of this process, they sent a list of questions to companies that might be interested in bidding. They rated each of the companies in a variety of areas, such as administration, background, customer service, communication and education, implementation, investments, reporting, legal and compliance, and systems and technology. The rating was based on responses to questions in all of these areas.[1489] This process narrowed down the number of firms considered in the search process.

[1486] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 51 (Feb. 5, 2002).

[1487] The change in recordkeepers under the deferral plans is also discussed in Part III.C.1., below.

[1488] Letter from Watson Wyatt to Cynthia Barrow, dated January 26, 2001, EC000022055-58.

[1489] Pre Screen Vendors, EC00022066-78. Pre Screen Vendors, EC000022110-28.

A request for proposal was sent to four vendors in 2001, with an initial date for the response of March 9, 2001.[1490] The date was extended to March 13, 2001, due to adverse weather conditions in the Northwest United States.[1491] The 16-page request for proposal included a statement of objectives, requirements for the service provider, plan summary information, and questions to be answered with respect to a variety of administrative and investment issues. For example, the request for proposal indicates a need for daily valuation, interactive voice response systems, transactional and information web access, and a brokerage investment option. The request for proposal indicated July 1, 2001, as the date the conversion was to be completed and the system operational. The request for proposal asked respondents to describe the blackout period that was expected to occur during the conversion process.[1492]

The process was similar to the process for the 1998 recordkeeper search. Watson Wyatt evaluated responses and provided quantitative weighted ratings overall and in specific areas. Follow-up questions were provided in some cases. Specific questions were asked with respect to concerns Enron had identified with the current recordkeeper. After Watson Wyatt consolidated responses, an Enron task force met to evaluate the responses from a cost and service standpoint. This led to the selection of two finalists--Hewitt[1493] and another company.[1494] Enron employees made site visits to both potential recordkeepers. Among other things, they looked at the computer capabilities and customer service. They listened to customer service calls to monitor the quality of responses.

Enron personnel told the Joint Committee staff that, after making the site visits, the team working with the Enron Savings Plan met with the group working with the 1994 Deferral Plan and Expat Deferral Plan and a joint decision was made. Documents provided by Enron say that the last firm, other than Hewitt, was eliminated due to cost to the program for the nonqualified deferred compensation plans.

[1490] EC000022082. Other documents indicate requests for proposals were sent to six companies. Timeline prepared for Administrative Committee, EC000001872.

[1491] EC000022099.

[1492] Enron Corp. Savings Plan Request for Proposal, EC000022083-98.

[1493] Enron was seeking a service provider for both recordkeeping and trust services. Because Hewitt does not provide trustee services, Hewitt obtained a quote from Wilmington Trust Company, and Hewitt and Wilmington Trust Company made submissions in response to the Enron request for proposal. Wilmington Trust Company was chosen as the new trustee to replace Northern Trust Company. Committee on Governmental Affairs, United States Senate. *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 107 (Feb. 5, 2002).

[1494] *See* Summary of All Proposals Total Weighted Score Comparison, EC000022164-66.

The Administrative Committee was notified on May 3, 2001, of the decision to hire Hewitt as the new recordkeeper. Northern Trust was notified in July 2001 that Enron would transfer recordkeeping services for the Enron Savings Plan to Hewitt.[1495]

The response to the request for proposal submitted by Hewitt contains the following regarding the blackout period:

> There will be a blackout period while the final valuation is performed on the prior recordkeeping system, balances are reconciled, and accounts are established on the system. The duration of the blackout is dependent on the prior valuation cycle and the timeliness of final balances from the prior recordkeeper. Typically, Hewitt does not require a blackout period of longer than two weeks (this includes one week the prior recordkeeper needs to send us the conversion data and reports)[.][1496]

The 2001 transition process

Deciding on the blackout dates (Enron stock price: $53.04 on June 1, 2001; $48.30 on July 1, 2001; $45.61 on August 1, 2001; $29.15 on September 1, 2001)

According to testimony of Hewitt, Hewitt and Enron signed a letter of intent in June 2001. The letter of intent contemplated that Hewitt would begin work immediately, and would be compensated for the work it performed if a final contract was not agreed to. Pursuant to the letter of intent, during June 2001, Enron and Hewitt worked on what Hewitt refers to as the "Delivery Model," which describes the services Hewitt would normally expect to provide as a recordkeeper, additional services they would provide to Enron, and services that Hewitt would not provide.[1497]

During July 2001, Hewitt began what they refer to as the "Requirements Process." They describe this as a "detailed and comprehensive" process intended to identify precisely the services to be performed and how and when they would be provided. Transition issues with respect to the change of recordkeepers was addressed at this time as well. Hewitt stated that Enron had proposed a "live date" of October 23, 2001, and that Hewitt identified all work needed to effect the transition and target dates for completion in order to meet the proposed live date.[1498]

[1495] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 101 (Feb. 5, 2002).

[1496] Hewitt Associates, Request For Proposal - Savings Plan Enron Corporation (March 12, 2001). EC000022242-91, at EC000022246.

[1497] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 107-08 (Feb. 5, 2002).

[1498] *Id.* at 108.

During this time, there were discussions involving Enron and the old and new trustees and recordkeepers. After discussion, Enron decided on a blackout period that would begin on September 14, 2001, and end on the live date of October 23, 2001. The planned blackout period was two-tiered: (1) participants would be restricted from taking loans or withdrawals or making rollover contributions, and making similar transactions from the close of trading on September 14, 2001, to October 23, 2001; and (2) participants would be restricted from changing investments from the close of trading on September 26, 2001, through October 23, 2001. Under this schedule, the asset transfer from Northern Trust to Wilmington Trust Company was to take place on October 1.[1499]

According to Hewitt, transition issues were revisited in mid-August 2001. Hewitt says they were informed that Enron had decided to make some plan design changes that would affect recordkeeping requirements and of which Hewitt was not previously aware. These changes included (1) replacing three Vanguard investment funds with Fidelity funds, and (2) eliminating Enron Oil and Gas Stock Fund as an investment option.[1500]

Enron personnel told the Joint Committee staff that they wanted to eliminate the Enron Oil and Gas Stock Fund because Enron Oil and Gas ("EOG") had been sold and was no longer part of the Enron group. Since Enron had no further connection with EOG, it was not believed to be an appropriate fund. Enron benefits department personnel determined that plan amendments needed to be made to eliminate the fund, and did not want to proceed until the Administrative Committee had acted on the amendments. These issues were initially discussed at the May 3, 2001, meeting of the Administrative Committee,[1501] and were approved at the Administrative Committee meeting on August 15, 2001.[1502]

Hewitt indicated that they would need approximately two to three weeks of additional time to make the necessary adjustments to their systems to reflect these changes. Enron decided to provide more time, and moved the proposed target dates back by about one month. Under the revised timetable, the new live date was November 23, 2001. The asset transfer to the new trustee was scheduled for November 1, 2001. The blackout period was now as follows: (1) participants would be restricted from taking loans or withdrawals or making rollover contributions or making similar transactions from the close of trading on October 19, 2001, to

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[1499] *Id.* at 109-110.

[1500] *Id.*

[1501] At that meeting, the Administrative Committee requested additional information with respect to the change from Vanguard Funds to Fidelity funds, including further information regarding comparability of the funds.

[1502] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 110 (Feb. 5, 2002); interviews by Joint Committee staff of Enron employees.

November 19, 2001: and (2) participants would be restricted from changing investments from the close of trading on October 26, 2001, to November 19, 2001.[1503]

October 4, 2001: initial notice of blackout periods mailed to plan participants (Enron stock price $33.10)

Hewitt representatives testified that, at Enron's request, they prepared a draft communication to employees regarding the change in trustee, recordkeeper, and certain changes in investment options. This draft was reviewed by Enron and Hewitt incorporated changes from Enron into their draft. The communication was mailed to participants by Hewitt on October 4, 2001, using address lists provided by Enron and Northern Trust. Hewitt testified that at this point it had not received the data necessary to prepare mailing labels. Hewitt personnel have testified that Hewitt did not participate in the preparation of mailing of any other communications materials regarding the blackout, although they are aware that other communications were sent.[1504]

This initial communication, titled "Enron Corp. Savings Plan Changes, Money in Motion" a six-page document.[1505] It includes the following under "What's New?"

"In late November, Hewitt Associates will become our new administrator for the Enron Corp. Savings Plan, providing improved customer service and quicker processing of your requests." It states that on November 20, the Fidelity Freedom Funds will replace the Vanguard LifeStrategy Funds. The communication also states that all investment funds will now be listed by asset class in order of risk factor, from the least risky to the most risky. It shows the mapping of the Vanguard funds to the Fidelity funds, i.e., the comparable Vanguard funds to which assets in each of the Fidelity funds will be transferred.[1506]

Under "Transaction Action Items" the document includes the following. "During the transition period, you will NOT have access to your funds. Your fund balances will remain invested in the market based on your fund choices as of 3:00 PM October 26."[1507] The document states that all activity must be completed by the dates indicated and explains that the reason for this transition is that fund balances of approximately $1.4 billion for 24,000 participants will be moved and balanced and that each record must be correct. It explains that once the records are balanced, investment returns and November payroll contributions will be added.[1508]

[1503] *Id.*

[1504] *Id.* at 110.

[1505] This document is included in Appendix D. EC000021560-65.

[1506] *Id.*

[1507] EC000021564. (Emphasis in original.)

[1508] *Id.*

The document includes the following as blackout dates:

- October 19, 3:00 PM CST as the last date for loan requests, in-service withdrawals and distributions, hardship withdrawals, loan payoffs, rollovers into the plan and SDA Schwab Fund Liquidation;
- October 26 3:00 PM CST as the last date for investment fund balance transfers/allocation changes and contribution rate changes;
- November 20 8:00 AM CST as the date transition ends. Savings plan system opens with all the great new features.[1509]

The document also describes changes that will take place, including a new online investment education and advice tool that is described as helping to turn financial dreams into reality.[1510]

October 16, 2001: Enron reports a loss (Enron stock price $33.84)

On October 16, 2001, Enron reported that it had lost $618 million for the quarter ended September 30, 2001, after taking into account after-tax nonrecurring charges of $1.01 billion. Enron also announced it was making a $1.2 billion reduction to shareholders' equity.

October 16, 2001, 11:10 PM: electronic mail to employees (Enron stock price $33.84)

An electronic mail message was sent to "All Enron Employees United States Group @ Enron."[1511] stating that, for all Enron Savings Plan participants, Friday, October 19 at 3:00 p.m. will be the last day to request a loan or a loan payoff or requests an in-service or hardship withdrawal. For self-directed account participants, Friday, October 19, 3:00 p.m. is given as the last day to make trades in the brokerage account to move holdings in kind.

The message states that other transactions, such as contribution rate changes and investment fund transfers, will continue until 3:00 p.m. on October 26.

October 19, 2001: blackout period with respect to distributions begins (Enron stock price $26.05)

On October 19, 2001, the blackout period with respect to loans and distributions began as scheduled.[1512]

[1509] *Id.*

[1510] EC000021562.

[1511] EC000021573. A copy of this message is included in Appendix D to this Report.

[1512] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 111 (Feb. 5, 2002). Timeline provided to

October 22, 2001, 10:28 pm: electronic mail message sent to employees (Enron stock price $20.65)

On October 22, 2001, an electronic mail message was sent to same group as the October 16 electronic mail message.[1513] The message cautioned that "October 26 is fast approaching," and reminded plan participants that Friday October 26 at 3:00 p.m. will be the last day to transfer investment fund balances and make contribution allocation changes, change the contribution rate for the November 15th payroll deductions, and enroll if the employee was hired before October 1.

The message contains a reminder regarding the change in investment funds from Vanguard to Fidelity, and states that funds will remain invested in the funds chosen as of 3:00 p.m. October 29 until 8:00 a.m. November 20, when the Enron Savings Plan reopens with "great new features."

The message provides contact information for those needing help during the transition.

October 25, 2001: Reconsideration of decision to move forward with blackout period for investment changes; electronic mail reminding employees of pending blackout (Enron stock price $16.35)

On the eve of the beginning of the blackout period for investment changes, there was concern in the benefits department about the timing of the blackout and the falling stock price. Mikie Rath, Benefits Manager, Enron Corp., testified that one employee had commented that the timing on the blackout was horrible, and that she tended to agree, but that the process had been well underway for some time.[1514] In addition, an employee had submitted an advance question for an all employee meeting to be asked Mr. Lay, "Now that I have lost all my retirement, what do I do? I have been here 20 years." Ms. Rath also indicated that there had been an all employee meeting in October and the facts had started to come out regarding problems of Enron.[1515]

In response to these concerns, Ms. Rath contacted Northern Trust on October 25, 2001, regarding the possibility of postponing the blackout date for investments until January 2002. Northern Trust personnel responded (on that date) that the date could be postponed, but that a January date could be problematic due to year-end demands on recordkeepers. They suggested as an alternative March 31, 2002.[1516]

Administrative Committee, EC000001913. This timeline is included in Appendix D to this Report.

[1513] EC000021574. A copy of this message is included in Appendix D to this Report.

[1514] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 55-56 (Feb. 5, 2002).

[1515] *Id.* at 50, 56-57.

[1516] *Id.* at 101-102.

Ms. Rath also contacted Hewitt on October 25, 2001, regarding either postponing the blackout date or shortening the period of the blackout. Hewitt responded on the same day that accelerating the live date would present a number of risk issues, including adverse effects of plan participants of restarting plan activities in the event the shortened period resulted in accurate plan records and possible compromising of the services that Hewitt could provide. They also pointed out a number of factors that Enron should consider in determining whether to delay the blackout, including extra cost, staffing implications, and the inability to predict when Enron stock would be less volatile.[1517]

After discussions with Hewitt and Northern Trust, Ms. Rath consulted her superior, the Senior Director of Benefits, Cynthia Barrow. They consulted their superior, Cindy Olson, the Executive Vice President, Human Resources, Employee Relations and Building Services as to whether to go forward with the blackout. Ms. Olson consulted two other Human Resources Vice Presidents and another Enron employee, and also contacted Enron's ERISA counsel. Ms. Olson said that she consulted with the other Human Resources Vice Presidents because of their general experience and that she consulted with the other Enron employee because that person had made comments regarding the timing of the blackout. All of these persons thought that the blackout should go forward. The ERISA counsel advised that they should go forward with the blackout because of the difficulty of notifying all plan participants of the postponement, particularly the inactive employees who did not have access to electronic mail. One employee suggested that another electronic mail be sent reminding participants about the blackout.[1518]

The decision was made to go forward with the blackout as planned and Enron notified Hewitt and Northern Trust by telephone that a decision had been made to go forward with the blackout period as planned.[1519]

According to documents provided by Enron, on October 25, at 11:44 p.m. another electronic mail message was sent to the same group of active employees reminding them that the blackout was going to take place. Enron personnel indicated that no additional communication was sent to other plan participants at that time.

The electronic mail message contained the following notice: "If you are a participant in the Enron Corp. Savings Plan, please read this very important message." The message indicated that there had been concern about the timing of the move to a new administrator and the restricted access to funds during the transition period. The message stated "We have been working with Hewitt and Northern Trust since July. We understand your concerns and are

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[1517] *Id.* at 54-55, 111-112; interviews of Enron employees by Joint Committee staff.

[1518] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 55-58; interviews of Enron employees by Joint Committee staff.

[1519] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 102, 112. (Feb. 5, 2002).

committed to making this transition period as short as possible without jeopardizing the reconciliation of both the Plan in total or your account in particular."[1520]

The message also included "reminders" that "the Enron Corp. Savings Plan is an investment vehicle for your **long-term** financial goals" and that "the Enron plan will continue to offer a variety of investment opportunities with different levels of risk."[1521] The message reminds participants to review their overall investment strategy and weigh the potential earnings of each investment choice against its risks before making decisions.

The message concludes: "For that reason, it is critical that **ALL** trades among your investment funds be completed by **3:00 PM CST Friday, October 26 before the transition period begins.**"[1522]

October 26, 2001: 11:58 AM; electronic mail message to Enron employees[1523] (Enron stock price $15.40)

On the morning of October 26, 2001, an electronic mail message was sent to same group as the earlier electronic mail messages. The message contained a "final reminder" of the October 26 blackout date and said that investment funds would be frozen as of 3:00 p.m. on that date for the duration of the transition period.[1524]

October 30, 2001: Hewitt requested to come to meeting of Administrative Committee (Enron stock price $11.16)

A Hewitt representative testified that she was contacted by the Enron Benefits Department on October 30, 2001, and asked to come to a meeting of the Administrative Committee on November 1, 2001. She said Hewitt was asked to be prepared to discuss the feasibility of shortening the blackout period and accelerating the live date to November 13, 2001.[1525]

November 1, 2001: Administrative Committee meeting (Enron stock price $11.99)

Documents provided by Enron indicate that, due to the volatility of Enron's stock and the fiduciary responsibility of the Administrative Committee, a special meeting of the

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[1520] EC000021575. A copy of this message is included in Appendix D to this Report.

[1521] *Id.*

[1522] *Id.*

[1523] EC000023713.

[1524] EC000021576. A copy of this message is included in Appendix D to this Report.

[1525] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 113 (Feb. 5, 2002).

Administrative Committee was held on November 1, 2001, to discuss the prudent steps that the Administrative Committee might need to consider with respect to the Enron Savings Plan, as well as other Enron qualified plans. Minutes of the meeting indicate that it was attended by four of the Administrative Committee members, a newly engaged attorney representing the Administrative Committee,[1526] Benefits Department personnel, three representatives from Hewitt, and Enron's ERISA counsel.

The Administrative Committee was presented with a snapshot of the current Enron stock holdings in the Enron Savings Plan and Enron ESOP as of October 26, September 30, and January 1, 2001. The Administrative Committee was advised that it had no duty to issue cautionary advice on the value or risk of holding Enron stock because the Administrative Committee does not act in the capacity of an investment advisor, but is charged with administering the plans in accordance with the terms of the plan documents and in compliance with ERISA. It was decided that the Administrative Committee should hire an independent investment advisor to monitor Enron stock, and a member of the Enron Treasury Department was directed to conduct the search.[1527]

At the Administrative Committee meeting, Hewitt summarized the decision to move forward with the Enron Savings Plan transfer and discussed the implications of attempting to unwind the transaction, i.e., have Northern Trust return to their prior role and postpone the date of transferring recordkeeping to Hewitt. Hewitt indicated that the asset transfer from Northern Trust to the new trustee had already taken place, and the old trustee would have to be contacted if that were to be undone. Hewitt stated that unwinding would extend the blackout period beyond November 20.

Hewitt was asked if it were possible to speed up the process to grant limited access to accounts by all participants by November 13. Hewitt stated that it was to receive data from Northern Trust on November 7, and that it would take five days to review and that the ability to shorten the blackout period was dependent on the quality of data received.[1528]

Administrative Committee minutes state that the Administrative Committee agreed that it was most prudent to move forward with the transition and asked the Benefits Department to set up an external website and to mail a postcard to all participants informing them to check for updates on the transition. It was decided that this was the most prudent and reasonable action to take under the circumstances. The minutes also state that, with respect to the Enron ESOP, it was determined that the Administrative Committee had no duty to take action since adequate

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[1526] The previous legal counsel for the Administrative Committee had had to resign due to conflicts of interest that had developed. It was agreed that the November 1, 2001, Administrative Committee meeting that the new attorney would represent the Administrative Committee at this meeting and the next pending a further agreement regarding his services.

[1527] Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001).

[1528] *Id.* Committee on Governmental Affairs, United States Senate, *Retirement Insecurity; 401(k) Crisis at Enron*, S. Hrg. 107-378, at 113 (Feb. 5, 2002).

communication has been given to participants over the years. The Administrative Committee would review the recommendations of the Investment Advisor as to what, if any, action might be required.

The Administrative Committee also determined that weekly meetings should be held during the transition period, and the next meeting date was scheduled for November 6. At that time, candidates for investment advisor to the Administrative Committee would be presented.

November 6, 2001: Administrative Committee meeting[1529] (Enron stock price $9.67)

The November 6, 2001, meeting of the Administrative Committee was attended (by person or via phone) by five members of the Administrative Committee, Benefits Department personnel, Enron ERISA counsel, counsel for the Administrative Committee, and two representatives from Hewitt.

The Administrative Committee discussed retaining an investment advisor to give guidance to the Administrative Committee on Enron stock in relation to the blackout period as well as current market conditions surrounding Enron stock.

Benefits Department personnel provided an update of the status of participant communications and the transition process. It was reported that the website for participants to check for updates was operational as of the time of the Administrative Committee meeting, and that a notification postcard would be mailed to all participants on November 8. Hewitt informed the Administrative Committee that the transition was on target and that Hewitt would make every prudent effort possible to shorten the blackout period.

Pending lawsuits were also discussed.

November 7, 2001: data transfer from Northern Trust to Hewitt (Enron stock price $9.05)

On November 7, 2001, Hewitt received the data transfer from Northern Trust.[1530]

November 8, 2001: post card mailed to plan participants (Enron stock price $8.41)

At the request of Enron, Hewitt mailed a post card to plan participants on November 8, 2001. Hewitt says that they used participant address lists provided by Northern Trust and Enron in making the mailing.[1531] The post card stated that "Enron and Hewitt are committed to making this period as short as possible so we have established a phone number and a web address that

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[1529] *See* Minutes of Administrative Committee Meeting (Nov. 6, 2001).

[1530] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity; 401(k) Crisis at Enron*, S. Hrg. 107-378, at 37 (Feb. 5, 2002).

[1531] *Id.* at 113-114.

enables you to get current information in a timely manner." The postcard also stated: "Stay connected to watch for an earlier access date."[1532]

November 13, 2001: blackout ends, Administrative Committee meeting (Enron stock price $9.98)

Enron and Hewitt report that the plan went "live" on November 13, 2001, at 8:00 am.

An Administrative Committee meeting was held on November 13, 2001, at which the Administrative Committee received an update of the status of the Enron Savings Plan transition. Benefits Department personnel reported that the Enron Savings Plan was "live" as of 8:00 am that morning and that the transition update website and phone line reflected this information. It was noted that the blackout had ended five days earlier than originally planned.

It was reported that on that day prior to the time of the Administrative Committee meeting, the plan website had experienced 200-250 hits and that the plan had not seen large movements in accounts.

The Administrative Committee chair requested that another electronic mail message be sent to employees to remind them that the transition period had ended.

An update on the investment advisor search was also provided at that time. It was reported that the selection process was expected to be finished by Friday, November 16, 2001.

Pending lawsuits were also discussed.

November 14, 2001, 9:07 PM:[1533] electronic mail to Enron employees notifying them that the blackout had ended on November 13 (Enron stock price $10.00)

An electronic mail message dated November 14, 2001, at 9:07 p.m. was sent to the same group of employees as previous electronic mail messages. The message announces an early end to the transition period and says that the internet site went live as of 8:00 a.m., November 13, the previous morning. It tells employees to log on to benefits.enron.com, to enjoy the new features.

This notice was sent 36 hours after the blackout had ended. Enron personnel interviewed by the Joint Committee staff were not able to specifically explain the delay. Joint Committee staff were told that the process for sending electronic mails to all employees was to send the message to a center for transmittal, and they were sent when they got around to them.

[1532] *Id.* at 122.

[1533] EC000023719.

Miscellaneous employee communications

Documents provided to the Joint Committee staff by Enron include additional employee communications that are not dated. These appear to be printouts from a website. They are as follows.

Undated web printout[1534]

This document tells people to stay connected to watch for an earlier access date.

Undated web printout[1535]

This document appears to be printout from a web page. Heading: "Welcome to your Enron Corp. Savings Plan Transition Update Site"--a website designed to bring you the most up-to-date news on the progress of the Savings Plan move to Hewitt Associates.

The document says: Update November 13, 2001, "The Savings Plan system is up and live as of 8:00 AM!" Provides wed address and telephone number to check on account, check out the new website or make changes.

The document also contains the following (historical) information:

- November 7: All participant information for approximately 24,000 participants will transfer.
- Activities for week ending 11/2/01:
  a. November 1: Savings Plan and ESOP balances transferred to new trust, remaining assets in the three Vanguard LifeStrategy funds mapped to the new Fidelity Freedom Funds;
  b. October 26: 187 investment transfers completed by the 3:00 PM deadline;
  c. October 22: The self-directed brokerage account began its migration from Schwab to CSFBdirect. With the exception of some mutual funds, no holdings were liquidated.

Involvement of the Administrative Committee

The first mention of a search for a new recordkeeper specifically for the Savings Plan appears in the Administrative Committee meeting on May 3, 2001. The minutes state that Ms. Rath reviewed the reasons for and status of the Enron Savings Plan recordkeeper and trustee vendor search.[1536] Ms. Rath presented the decision for the move to Hewitt Associates as

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[1534] EC000023718.

[1535] EC000023721.

[1536] The minutes refer to an Attachment III for this agenda item. The documents supplied by Enron in response to Joint Committee staff request do not label Attachment III or describe either the reasons for or the status of the search. The Joint Committee staff has been unable to determine whether we have the complete documents provided to the Administrative

recordkeeper and Wilmington Trust as trustee. She recommended that the Administrative Committee approve the elimination of the Enron Oil and Gas Stock Fund and the switch from Vanguard LifeStrategy Funds to Fidelity Freedom Funds. The Administrative Committee requested Ms. Rath to work with another Enron employee to determine whether the Fidelity Funds are a comparable class and optimal fee structure. It was decided that these matters would be brought back to the committee at the August 15th meeting for a vote.

The materials provided to the Administrative Committee in connection with this agenda item are:

(1) A one-page paper titled "Vendor Search" which says "Revised 1998 request for proposal and sent to": **Hewitt Associates, Fidelity**, Prudential, PaineWebber/Putnam, Merrill Lynch, Invesco, Citistreet, JP Morgan/American Century (emphasis in original).

(2) A one-page paper titled "Investment Offerings" which refers to the elimination of the Enron Oil and Gas Stock Fund and the recommended investment switch from Vanguard to Fidelity Funds. Also says "Increase rebate from Fidelity by $59,172.57/qtr."

(3) A one-page paper titled "Enron Corp. Savings Plan Fund Performance Average Annual Total Returns For The Period ended March 31, 2001," which compares certain Vanguard funds with Fidelity funds.

(4) Four pages of materials which describe the Fidelity Freedom Funds.

(5) Three pages of materials describing Vanguard LifeStrategy Funds.

While not clear, the first document referenced above appears to mean that, in making the search, the 1998 request for proposal was revised and sent to the listed service providers. The two bolded names were the two final providers considered in the process, with Hewitt being chosen.

As discussed above, the Administrative Committee discussed the status of the blackout at the November 6, 2001, meeting.

Subsequent Administrative Committee meetings

Issues relating to the change of recordkeeper were discussed at some subsequent Administrative Committee meetings. At the Administrative Committee meeting on November

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Committee on this matter. The materials described here were included with the minutes and relate to this item, so it is assumed they were provided for this item.

20, 2001, a timeline of the events leading to the change of recordkeepers was discussed.[1537]

At the Committee meeting on December 11, 2001, copies of the following were provided to the Committee: employee communications and an updated timeline documenting the sequence of events relating to the blackout; a copy of the prior presentation by in-house counsel regarding the roles and responsibilities of the Administrative Committee; and a copy of a draft analysis by of the history of the stock price and the transition period.

Enron Savings Plan holdings of Enron stock and transactions in Enron stock

According to information provided by Ms. Rath to the Senate Committee on Governmental Affairs, at the time the blackout of investments began under the Enron Savings Plan on October 26, 2001, approximately 26 percent of the assets of the Enron Savings Plan were invested in Enron stock. At this time, approximately 58 percent of the Enron Savings Plan investment in Enron stock was due to participant investment elections with respect to participant contributions and 42 percent was due to Enron matching contributions. Approximately 22 percent of plan participants at that time were eligible to reinvest the matching contributions in something other than Enron stock.[1538]

For the two weeks preceding October 26, 2001, Enron Savings Plan participants were net buyers of Enron stock. During this period, Enron Savings Plan participants purchased $15.770 million of Enron stock and sold $11.553 worth of Enron stock. Also during this period, the number of Enron Savings Plan participants who bought Enron stock (501 participants) outnumbered plan participants who sold Enron stock (224 participants) by more than a two to one margin.[1539]

In contrast, for the two week period after the blackout period ended on November 13, 2001, Enron Savings Plan participants were net sellers of Enron stock.[1540]

Enron Savings Plan provisions relating to third party service providers

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[1537] EC000001909-16. An updated copy of this timeline was presented at the December 11, 2001, Administrative Committee Meeting. A copy of this document is included in Appendix D to this Report.

[1538] Responses to questions for the record submitted on behalf of Mikie Rath by Swidler Berlin Shereff Friedman, LLP, *Retirement Insecurity: 401(k) Crisis at Enron*, Hearing before the Committee on Governmental Affairs, United States Senate, S.Hrg. 107-378, at 188-89 (Feb. 5, 2002).

[1539] Responses to questions for the record submitted by Northern Trust Retirement Consulting, LLC, *Retirement Insecurity: 401(k) Crisis at Enron*, Hearing before the Committee on Governmental Affairs, United States Senate, S.Hrg. 107-378, at 191 (Feb. 5, 2002).

[1540] Responses to questions for the record submitted by Hewitt Associates, *Retirement Insecurity: 401(k) Crisis at Enron*, Hearing before the Committee on Governmental Affairs, United States Senate, S.Hrg. 107-378, at 200 (Feb. 5, 2002).

Section XV.6 of the Enron Savings Plan (as amended and restated effective July 1, 1999) provides as follows:

> Notwithstanding any provision of the Plan or the Trust Agreement to the contrary, the Company may, in its sole discretion, engage any service provider which is not an employee or a subsidiary of the company to perform identified administrative serves with respect to the Plan ("Third-Party Administrative Services"). In the event that the Company so engages any such service provider to perform Third-Party Administrative Service, then notwithstanding any provision of the Plan to the contrary, the Company shall be fully responsible and accountable for selecting, credentialing, overseeing, and monitoring such service provider, including without limitation, evaluating the quality of performance, determining whether the fees charged are reasonable, and removing or replacing such service provider, as the Company deems to be necessary or appropriate in its discretion. Upon engaging a service provider to perform Third-Party Administrative Services, the Company shall advice the Committee in writing regarding such engagement identifying the service provider and the Third-Party Administrative Services which are to be performed by such service provider. Thereafter the Committee shall have not power, duty, or responsibility with respect to such Third-Party Administrative Services and shall have no power, duty or responsibility to monitor the performance of such service provider.

Discussion of Issues

Changes in third party service providers, including plan recordkeepers, are a normal part of qualified plan operation. Changes in recordkeepers may be made for a variety of reasons, including mergers of plans due to corporate transactions, problems with a current recordkeeper, fee differences between comparable providers, and investment or other plan changes. A change in recordkeepers generally will involve some interruption or blackout of normal plan operations; the extent and duration of the interruption will depend on a variety of factors, including the nature of services provided, plan features (e.g., whether loans are permitted and how often investment changes can be made), the number of plan participants and accounts, and the accuracy of the information being transferred. Some recordkeepers have commented that the latter feature is often a key element determining the length of any blackout period, because if the transferred data is not accurate, then the reconciliation process will take longer.

The decision of when to implement a change, i.e., when to impose a plan blackout, may also depend on a variety of factors, including when a change is likely to have the least effect on plan operations and administrative convenience for the new and old recordkeeper and others involved in plan administration. Once chosen, blackout dates may be changed due to necessity or convenience. For example, as described above, the blackout for the Enron Savings Plan was originally scheduled to begin on September 14, 2001. The date was deferred (prior to the time participants were notified of the change) because of a perceived need to make additional plan amendments. In some cases, unanticipated problems discovered either before a blackout has begun or during a blackout may result in a delay in implementing the blackout or a delay in restarting full normal plan operations.

Actions relating to a change in plan recordkeepers are subject to ERISA's general fiduciary provisions. Thus, if ERISA's fiduciary standards are not met in connection with a change in recordkeepers, including implementation of any blackout period, fiduciary liability for losses may be imposed.

The blackout associated with the Enron Savings Plan in November 2001 has received considerable attention due to the timing of the blackout and the decline in the value of Enron stock during this period. At the beginning of the blackout, Enron stock was $15.40 per share, compared to $9.98 per share at the end of the blackout. This is a 35 percent loss in value during the blackout period. However, Enron's stock price was falling before the blackout, and participants who wished to could have sold stock previously. For example, on February 1, 2001, Enron stock price was $78.79, and on October 25, 2001, the day before the blackout began, Enron stock price was $15.35. During this period, the price of the stock fell 81 percent. Until the blackout, there is some indication that Enron employees viewed Enron stock as a good investment. As described above, Enron Savings Plan participants were net buyers of Enron stock just before the blackout. During the blackout, attitudes regarding the future of the company may have changed; Enron Savings Plan participants were net sellers of Enron stock.

The main issue raised with respect to the change in recordkeepers under the Enron Savings Plan is whether plan fiduciaries, including the Enron Savings Plan Administrative Committee, acted in accordance with their fiduciary obligations in implementing the blackout period or whether they should have stopped the blackout from occurring given the falling price of Enron stock and its financial circumstances, thereby possibly allowing plan participants to reduce their losses. In hindsight, the blackout was ill-timed. However, the actions of plan fiduciaries should be evaluated based on what was known (or should have been known) at the time.

One issue is whether the Administrative Committee (or other plan fiduciaries) should have acted to postpone the blackout. The Administrative Committee, although informed about matters related to the change in recordkeepers, did not become actively involved until the blackout was underway. At that point, the Administrative Committee became concerned with the possibility of accelerating the end of the blackout period.

On the eve of the blackout, the possibility of postponing the blackout due to volatility of Enron stock was considered by Enron personnel. Although the Administrative Committee was not formally involved in this decision, Cindy Olson, a member of the Administrative Committee and also, at the time, Executive Vice President, Human Resources and Community Relations, Enron Corp., was involved. In deciding to go forward with the blackout, she consulted with two other human resources vice presidents and Enron's ERISA counsel.[1541]

[1541] Committee on Governmental Affairs, United States Senate. *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 57. (Feb. 5, 2002); interview of Cindy Olson by Joint Committee staff.

According to Ms. Olson, the blackout was not postponed due to the difficulty of providing notice of the postponement to all plan participants.[1542] Part of this reasoning appears to be a concern that different groups of participants not be treated differently, and part of this appears to be due to the thought that if not all participants could be notified, the blackout would go into effect as a practical manner in any case for some participants. The first concern is undermined somewhat by the fact that during the transition process to the new recordkeeper, Enron routinely provided different notices to different groups of plan participants.

Issues involving possible fiduciary liability relating to the blackout are being addressed in litigation.

Another issue that arises with respect to the blackout is whether plan participants received notice of the blackout sufficient to allow them to make appropriate decisions in anticipation of the blackout. The information reviewed by the Joint Committee staff indicates that Enron provided a variety of notices to plan participants regarding the blackout. The Joint Committee staff did not undertake to determine whether all plan participants received notice of the blackout; however, the Joint Committee staff determined that various groups of plan participants received different notices regarding the blackout. In particular, active plan participants (i.e., those currently employed by Enron) were sent numerous electronic mail messages regarding the blackout. Inactive plan participants (i.e., those not currently employed by Enron) were not sent such electronic messages, nor comparable messages regarding the blackout. Thus, active employees received more reminders of the blackout than other plan participants. The exact group of employees to whom the messages were sent is unclear, as Enron did not respond to the Joint Committee staff request to explain the group electronic mail address.

Even active employees did not all receive the same notices. In particular, it appears that PGE employees did not receive all the electronic mail messages addressed to Enron employees generally.[1543] Enron employees indicated to the Joint Committee staff that this was due to technical error, and that it was not uncommon for electronic mail links to break down between Enron and its related companies.

5. Investments under the Enron Savings Plan

Present Law

ERISA

As discussed above,[1544] ERISA generally provides that a person is a plan fiduciary to the extent the fiduciary exercises any discretionary authority or control over management of the plan or exercises authority or control over management or disposition of its assets, renders investment

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[1542] *Id.*

[1543] A note from a PGE employee to Ms. Rath states that PGE employees did not receive the electronic mail messages of October 16, October 22, and October 26, 2001. EC000021566.

[1544] *See* Part II.A.3., above.

advice for a fee or other compensation, or has any discretionary authority or responsibility in the administration of the plan. Under ERISA, the person deciding how to invest the assets of a pension plan or selecting an investment manager generally is a fiduciary by virtue of those actions. ERISA imposes a number of specific fiduciary obligations on that person or entity, including the duty to diversify plan investments. Limited exceptions permit certain defined contribution plans to hold an unlimited amount of plan assets in employer securities.[1545]

Additionally, ERISA requires that plan assets be held in trust and that the trustee (or the named fiduciary that directs the trustee) have "exclusive authority and discretion to manage and control the assets of the plan."[1546]

Under a so-called safe harbor rule, ERISA fiduciary liability does not apply to investment decisions made by plan participants if plan participants control the investment of their individual accounts.[1547] Many employers design plans to meet the safe harbor in order to minimize fiduciary responsibilities. If the safe harbor applies, a plan fiduciary may be liable for the investment alternatives made available, but not for the specific investment decisions made by participants. This includes investments in employer securities made at the direction of a participant. Failure to satisfy the safe harbor rule means that plan fiduciaries may be held liable for the investment decisions of participants.

In order for the safe harbor to apply:

- the plan must provide at least three different investment options, each of which is diversified and has materially different risk and return characteristics;
- the plan must allow participants to give investment instructions with respect to each investment option under the plan with a frequency that is appropriate in light of the reasonably expected market volatility of the investment option;
- at a minimum, participants must be allowed to give investment instructions at least every three months with respect to at least three of the investment options, and those investment options must constitute a broad range of options (the three-month minimum rule);
- participants must be provided with detailed information about the investment options, information regarding fees, investment instructions and limitations, and copies of financial data and prospectuses; and
- specific requirements must be satisfied with respect to investments in employer securities to ensure that employees' buying, selling, and voting decisions are confidential and free from employer influence.[1548]

[1545] *See* Part II.A.4., above.

[1546] ERISA sec. 403(a).

[1547] ERISA sec. 404(c).

[1548] Additional limitations on the safe harbor include that it generally does not apply to any investment instruction of a participant which, if implemented, would result in an acquisition or sale of any employer security except to the extent that the securities are publicly traded and

In addition, the safe harbor applies only with respect to a transaction if a participant exercises independent control in fact with respect to the assets in his or her account. Whether a participant has exercised independent control in fact with respect to a transaction depends on the facts and circumstances of the particular case. However, a participant's exercise of control is not independent in fact if:

- the participant is subjected to improper influence by a plan fiduciary or the employer
- with respect to the transaction;
- a plan fiduciary has concealed material nonpublic facts regarding the investment from
- the participant, unless the disclosure of the information by the plan fiduciary to the
- participant would violate other law not preempted by ERISA; or
- the participant is legally incompetent and the responsible plan fiduciary accepts the participant's instructions knowing this.

If the safe harbor is being relied upon, then participants must be permitted to change investment decisions in a manner consistent with that safe harbor or the safe harbor will not apply. Unless the safe harbor is being relied upon, there are no specific rules regarding how often a plan must permit participants to change investments.

Rules relating to investments in employer securities[1549]

In general, the assets of either a defined contribution plan or a defined benefit plan may be invested in employer securities. The rules relating to such investments differ for defined benefit plans and defined contribution plans. ERISA rules applicable to defined benefit plans prohibit such plans from acquiring employer securities if, after the acquisition, more than 10 percent of the assets of the plan would be invested in employer securities. Most defined contribution plans, such as profit-sharing plans, stock bonus plans, pre-ERISA money purchase plans, 401(k) plans and ESOPs, generally are not subject to this limitation. In general, there is no limit on the amount that an employee can choose voluntarily to invest in employer securities in a defined contribution plan.

A defined contribution plan can generally require that some or all plan contributions must be invested in employer securities, with no opportunity to change investments. It is common for 401(k) plans to require that the employer match be invested in employer securities.

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are traded with sufficient frequency and in sufficient volume to assure that participant and beneficiary directions to buy or sell the security may be acted upon promptly and efficiently. ERISA reg. sec. 2550.404c-1(d)(2)(ii). In connection with such an acquisition or sale, the regulations also include requirements pertaining to the provision of information about such securities to participants and beneficiaries as well as voting, tender, and similar rights with respect to such securities. *Id.*

[1549] For a more detailed discussion of these rules, *see* Part II.A.4., above.

Factual Background

In general

Under the Enron Savings Plan, participants generally may contribute from one to 15 percent[1550] of their base pay in any combination of elective deferrals[1551] or after-tax contributions, subject to the limits prescribed by the Code. Materials reviewed by Joint Committee staff showed that participants generally could change the amount of their contributions monthly and could stop their contributions at any time.[1552] Such changes generally would be effective within one month.[1553]

Participants may also roll over amounts from other plans to the Enron Savings Plan in certain circumstances ("rollover contributions").

Enron contributed as matching contributions amounts equal to a percentage of participants' contributions to the Enron Savings Plan to participants' company contribution accounts.[1554] Enron's matching contributions under the Enron Savings Plan historically were invested "primarily" in Enron Corp. common stock and could not be reinvested by employees in another investment until they turned age 50.[1555]

The amount of Enron's matching contribution varied over time. Under the 1994 version of the Enron Savings Plan, Enron contributed 100 percent of participants' elective deferrals and after-tax contributions, up to six percent of their base pay, depending on the participant's years

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[1550] At one point, 14 percent was the maximum permitted contribution. Summary of Enron Savings Plan (undated), at 118. The Enron Savings Plan provides that the contribution amount must be an integral percentage. Sec. 3.2, Enron Savings Plan (July, 1, 1999, restatement).

[1551] For a description of elective deferrals, *see* Part II.A.2., above.

[1552] *See The Enron Retirement Program Guide,* included in Appendix D to this Report.

[1553] Changes made to the amount of a participant's contribution before the 15th of any month would be effective within one to two payroll periods following the change. Changes made after the 15th would be effective the following month. *Money in Motion - 401(k) Plan Details,* DOL020522.

[1554] Additionally, in November 1996, Enron announced a special $300 contribution to the Enron Savings Plan on behalf of regular full-time Enron employees. Participants would automatically be 100 percent vested in the contribution, which would be made in mid-January 1997 and would be invested in Enron stock. *EnSight* (Nov. 1996), EC000020134-EC000020137.

[1555] The Enron Savings Plan provides that matching contributions to the accounts of participants who are Enron Oil & Gas employees are to be invested primarily in shares of Enron Oil & Gas stock. Sec. 5.1(a) of Enron Savings Plan (July 1, 1999, restatement).

of service.[1556] Effective January 1, 1998, the Enron Savings Plan was amended to provide that notwithstanding participants' years of service, for 1998, Enron would contribute a matching contribution equal to 50 percent of a participant's elective deferrals, up to two percent of base pay. The January 1, 1999, version of the Enron Savings Plan provides that Enron's matching contribution for 1999 was equal to 50 percent of participants' elective deferrals up to four percent of base pay. For 2000 and 2001, the limit was six percent of compensation. These contributions were discontinued effective November 28, 2001.[1557]

Role of the Administrative Committee

The Enron Savings Plan Administrative Committee is the plan administrator and named fiduciary for purposes of ERISA,[1558] except with respect to the investment of assets of the trust fund, for which the plan trustee is the named fiduciary.[1559] The trust agreement under the Enron Savings Plan provides that the named fiduciary thereunder is the organization, entity, or other person responsible for benefit administration under the Enron Savings Plan.[1560] Further, it provides that the named fiduciary is responsible for management and control of the Enron Savings Plan trust fund and is responsible for determining the "diversification policy."[1561] The trust agreement also provides that the named fiduciary may delegate discretionary authority for the management and control of all or any portion of the trust to investment managers.[1562]

As discussed above in Part II.B.3., above, the Administrative Committee generally did not evaluate Enron stock as an appropriate investment under the Enron Savings Plan. The Administrative Committee questioned for the first time whether it should be examining Enron stock as an investment under the Enron qualified plans at a special meeting of the Administrative

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[1556] Sec 3.4. Enron Corp. Savings Plan (Jan. 1, 1994, restatement).

[1557] Third Amendment to Enron Corp. Savings Plan (July 1, 1999, restatement), DOL020351-DOL020354.

[1558] Sec. 13.1 of Enron Savings Plan (July 1, 1999, restatement).

[1559] Sec. 14.1(a) of Enron Savings Plan (July 1, 1999, restatement).

[1560] Sec. 1.1 of the Trust Agreement between Enron Corp. and the Wilmington Trust Company, as Trustee (effective Nov. 1, 2001) ("Trust Agreement"). The Trust Agreement between Enron and Wilmington Trust was effective November 1, 2001. Documents reviewed by Joint Committee staff indicate that The Northern Trust Company previously served as trustee to the Enron Savings Plan. The trust agreement also allocates the authority of the named fiduciary to the organization, entity, committee or other person who has authority to perform the functions allocated to it under the trust agreement. *Id.*

[1561] *Id.*

[1562] *Id.* at sec. 4.1.

Committee on November 1, 2001.[1563] Documents provided by Enron indicate that, due to the volatility of Enron's stock and the fiduciary responsibility of the Administrative Committee, the special meeting was called to discuss the prudent steps that the Administrative Committee might need to consider with respect to the Enron Savings Plan, as well as other Enron qualified plans. Minutes of the meeting indicate that it was attended by four of the Administrative Committee members, a newly engaged attorney representing the Administrative Committee,[1564] Benefits Department personnel, three representatives from Hewitt, and Enron's ERISA counsel.

The Administrative Committee was presented with a snapshot of the current Enron stock holdings in the Enron Savings Plan on January 1, September 30, and October 26, 2001. The Administrative Committee was advised that it had no duty to issue cautionary advice on the value or risk of holding Enron stock because the Administrative Committee does not act in the capacity of an investment advisor, but is charged with administering the plans in accordance with the terms of the plan documents and in compliance with ERISA. It was decided that the Administrative Committee should hire an independent investment advisor to monitor Enron stock.

At a November 6, 2001, meeting, the Administrative Committee discussed retaining an investment advisor to give guidance to the Administrative Committee on Enron stock in relation to the Administrative Committee's operation of the plans.[1565] Minutes of the meeting indicate that the Administrative Committee agreed that the role of the advisor would be to give advice on Enron stock and to assist the Administrative Committee in operating the plans in the best interests of its participants.[1566] Additionally, it was decided that the Administrative Committee should select an independent investment advisor to monitor Enron stock, and an Enron Treasury Department employee was directed to conduct the search.[1567]

Investment authority and investment decisions under the Enron Savings Plan

Upon enrolling in the Enron Savings Plan, participants select the fund or funds in which they want to invest their contributions. The Plan provides that participants' elective deferrals and after-tax contributions may be invested into any combination of funds offered by the

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[1563] Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001847-EC000001855.

[1564] The previous legal counsel for the Administrative Committee had had to resign due to conflicts of interest that had developed. It was agreed that the November 1, 2001, Administrative Committee meeting that the new attorney would represent the Administrative Committee at this meeting and the next pending a further agreement regarding his services.

[1565] Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001858-EC000001860.

[1566] *Id.*

[1567] *Id.*

Plan.[1568] Participants' rollover contributions may also be invested in any combination of investments available under the Plan.[1569]

The Enron Savings Plan provides that participants may change their investment selections prospectively as well as with respect to amounts already invested under the Plan.[1570] The Plan provides that the manner and frequency of such changes are subject to procedures established by the Enron Savings Plan Administrative Committee.[1571]

Participants generally can make changes in investment choices for future contributions and transfer current balances from one fund to another on any business day.[1572] Participants wishing to make a change from one fund to another could call a phone line for the Enron Savings Plan or make the change electronically, through a website for the Plan.[1573] Participants would receive written confirmations of transactions.[1574]

With respect to Enron's matching contributions, the Enron Savings Plan generally provided that upon turning 50, participants may elect to reallocate their company contribution account balances among other investment options offered under the Enron Savings Plan. For this purpose, participants could designate one investment fund for all the amounts allocated or may split the investment of such amounts between investment funds. However, effective November 28, 2001, the Enron Savings Plan was amended to provide that notwithstanding their age, participants could reinvest the amounts in their company contribution accounts in the investment funds offered under the Plan.

Effective February 15, 2002, the Plan was amended to provide that the portion of a rollover contribution including Enron stock or other "employer securities" will continue to be so invested until the participant elects to convert it into another investment under the Plan.[1575] Effective March 15, 2002, the Plan was amended to provide that participants may not elect to

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[1568] Participants can invest in any or all funds offered under the Plan as long as the investment allocations are made in one percent increments and total 100 percent. *See The Enron Retirement Program Guide.*

[1569] Sec. 5.3 Enron Savings Plan (July 1, 1999, restatement); *Money in Motion,* DOL 020252.

[1570] Sec. 5.2 Enron Savings Plan (July 1, 1999, restatement); *Money in Motion,* DOL 020252.

[1571] *Id.*

[1572] *Money in Motion,* DOL020252.

[1573] *Id.*

[1574] *Id.*

[1575] Sixth Amendment to Enron Corp. Savings Plan (July 1, 1999, restatement).

convert any investment of any portion of their accounts under the Plan into an investment in Enron stock or any other "employer security."[1576]

Plan investment options available to participants

During the period reviewed by Joint Committee staff, participants could invest their contributions to the Enron Savings Plan in up to 20 investment options[1577] as long as the whole percentages chosen totaled 100 percent.[1578] The options included several mutual funds, Enron stock, and beginning in 1999, a Schwab account that functioned like a self-directed brokerage account,[1579] through which participants could invest in almost any individual stock or mutual fund.

The particular funds available under the Enron Savings Plan varied over time. During the period covered by the Joint Committee review, they included Enron stock as well as funds sponsored by a variety of financial institutions.[1580]

Information provided to participants

Enron produced a variety of employee benefit education materials for Enron Savings Plan participants. These included periodic newsletters, occasional special newsletters, electronic communications, and materials designed to meet legal requirements, such as summary plan descriptions.[1581] Materials provided to the Joint Committee staff show that Enron also periodically produced publications for participants which describe the investment options under the Enron Savings Plan. Examples of prospectuses for the funds available under the Enron Savings Plan were provided to Joint Committee staff.

[1576] *Id.*

[1577] The number of investment options varied over time.

[1578] *See generally* "Enron Savings Plan summary description."

[1579] SEC 1999 Form 11-K. Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 33 (Feb. 5, 2002).

[1580] See Table 4 through Table 9, below, for the identity of the various investment options under the Enron Savings Plan for 1996 through 2000.

[1581] *Money in Motion - 401(k) Plan Details*, a summary plan description for the Savings Plan, describes for participants the Plan features and details, as well as their rights under the Plan. DOL020532. In a section called "ERISA Rights," *Money in Motion* tells participants that ERISA requires the individuals responsible for managing the plan to act prudently and in their best interests. *Id.*

For example, Enron produced *Only You - Enron Retirement Planning - Tools and Information for Your Future.*[1582] *Only You* includes information to assist employees with determining how much to contribute to the Enron Savings Plan and how to invest their contributions.[1583] Additionally, an accompanying *Resource Guide*[1584] identifies resources through which employees could learn about investing. The *Resource Guide* lists the following types of assistance as provided by Enron:

- Information about Enron retirement benefits so that employees know what to expect when they retire;
- The "Wealthy Barber" video which provides advice about saving and investing;
- *Future$aver*, interactive retirement planning software, customized for Enron's benefit plans; and
- "Investing in Your Future" workbooks, emphasizing the importance of saving for retirement and focusing on the fundamentals of investing and the relationship between risk and return, the importance of diversification and the impact of time on investment results.

Employee meetings and company culture

Enron held periodic "all-employee" meetings. Depending on the location of the meetings, employees could attend the meetings in person. In addition, the meetings were typically broadcast to all employee locations. While the purpose of these meetings generally was not to discuss investment options under the Enron Savings Plan, the future of Enron and projected prices of Enron Corp. common stock were discussed.

The Joint Committee staff reviewed videotapes of nine employee meetings for the period February 1, 1999, to October 23, 2001. The meetings had a common format. Information regarding the most recent financial information, the future of the company, and any current changes or planned changes were addressed. The discussion was typically led by the Chairman (either Mr. Lay or Mr. Skilling, depending on the time frame) and two or three other high-ranking Enron officials, such as Mr. Skilling, Joseph Sutton and Mark Frevert. A question and answer session followed the presentations by such individuals. In many cases, the questions had been submitted in advance of the meeting.

[1582] *Only You - Enron Retirement Planning - Tools and Information for Your Future,* EC000020214-EC000020237.

[1583] For example, the *Only You Resource Guide* states that there is "no better way to save money than on a before-tax basis through payroll deduction. Thanks to the plans' tax advantages and wide variety of investment options, it simply can't be beat...Make the most of your investment options. Most of us are long-term investors and can take advantage of the more aggressive investment funds. Enron has also recently introduced three new "Lifestyle" investment funds designed to fit a variety of investor profiles," EC000020241.

[1584] *Only You Resource Guide*, EC000020238-EC000020257.

With two exceptions, described below, Enron stock was not discussed in the employee meetings specifically in the context of the Enron Savings Plan. However, the future of Enron and the projected value of Enron stock was always addressed. A positive picture of the future was generally presented. The view that all employees should be owners of Enron was also frequently addressed.

For example, at the employee meeting on July 13, 1999, Mr. Lay told employees that "[w]e think it's critical that every body has an ownership position in the company" and that it is "very possible before year end" that the stock price would reach $100 per share and that "there is a fairly good chance we could see the stock price double again in the next year to 18 months...Do that math on your Enron stock."[1585] On August 16, 2001, Mr. Lay explained to employees, "we think we're at the bottom of the cycle and want you [the employees] to enjoy the ride back up. And more importantly, we want you to work hard so we get that ride back up."[1586] The previous day, Enron stock closed at $40.25. Mr. Lay added, "we are a deep value stock" and "the company is doing extremely well." Also on August 16, 2001, Mr. Lay told Enron employees that "the next several months, the next few years are going to be great for Enron, great for Enron's employees...And that's all starting now." Enron stock closed at $36.85 that day.

As mentioned above, Enron stock was addressed in the context of the Enron Savings Plan at two employee meetings. At the February 1, 1999, meeting, Cindy Olson, Enron's Executive Vice President for Human Resources and Community Relations was asked to join Mr. Lay, and respond to the question "Should we invest all of our 401(k) in Enron stock?," submitted by an employee. She replied, "Absolutely!"[1587]

According to Ms. Olson, the question was impromptu and her reply, which was intended to be humorous, was "greeted with laughter by those running the meeting and by the audience."[1588] In her view, when taken in the context of the meeting, it is clear that this was not

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[1585] July 13, 1999, employee meeting.

[1586] Mr. Lay was explaining to Enron employees that an additional issuance of stock options would be made to them. The options would vest in one year, instead of over five years as under previous similar programs.

[1587] In an interview with Joint Committee staff, Ms. Olson said she had no "on-the-ground detailed knowledge" of the Savings Plan despite the fact that she served on the Administrative Committee from January 2001 to March 2002. According to Ms. Olson, her responsibilities were more in the nature of customer service: to ensure that the Savings Plan was administered properly "in accordance with the culture" and that participants "got the services they needed." She said that she was not involved with the Savings Plan from a technical standpoint.

[1588] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 182-183 (Feb. 5, 2002).

intended as a serious statement. She also stated that she generally stressed diversification of investments.[1589]

At an employee meeting on October 23, 2001, Mr. Lay directly answered employee questions. To the question "I'm showing little in my 401(k). Any speculation on whether there will be any guarantee of pensions for those with 10 or 20 years of service?", Mr. Lay included as part of his answer, "Enron stock--we'll bring it back. We're gonna bring it back."

A few weeks following the meeting, on November 8, 2001, Enron announced its intention to file restated financial statements for the years December 31, 1997, through 2000, and for the first and second quarters of 2001.[1590]

Current and former employees interviewed by the Joint Committee staff indicated that there was a general culture encouraging employee ownership of Enron stock and that it was part of the Enron philosophy that all employees should also be owners of the company. Employees interviewed by the Joint Committee staff generally expressed continued loyalty to Enron, despite their own financial losses. One former employee of an Enron subsidiary gave the following testimony at a Congressional hearing:

> Throughout my time with Enron, the top management of the company constantly encouraged us to invest our savings in Enron stock. I took the fact that the company matched our savings only with Enron stock as a further endorsement of the stock as a safe retirement investment. More recent statements made by Enron's top management, including e-mails from Ken Lay, about the company's stock also caused me to keep investing my savings into the stock. I remember, in the Fall of 2000, Enron's top executives telling us at an employee meeting and by company e-mail that Enron's stock price was going to increase to at least $120 per share. When Mr. Skilling resigned last

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[1589] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 40, 44 (Feb. 5, 2002). Additionally, Ms. Olson provided Joint Committee staff with examples of her responses to questions e-mailed to her by Enron employees about their benefits. In answering one such question, Ms. Olson wrote: "We encourage employees to discuss these questions with a financial advisor or tax expert. Because everyone's situation, risk tolerance and diversification goals are different, there is no one solution that works for everyone." Printout of *Enron Options, Featuring Cindy Olson, executive vice president, Human Resources & Community Affairs* (Nov. 2, 2000). Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron,* S. Hrg. 107-378, at 177-78 (Feb. 5, 2002).

[1590] SEC Form 8-K, filed with the Securities and Exchange Commission on November 8, 2001.

August, Mr. Lay told us that the company was stronger than it had ever been....Our stock ownership was encouraged by Enron's top management.[1591]

The Joint Committee staff was told that Enron employees were constantly aware of the price of Enron stock, and that, until the bankruptcy filing, the current stock price was displayed on a monitor in the lobby of the Enron building.

Historical information regarding distribution of plan investments by type of investment

Table 4 through Table 9, below, show the general distribution of investments under the Enron Savings Plan by type of investment for the years 1996 to 2000 and as of October 26, 2001. The source of the data for 1996 to 2000 is the Forms 11-K[1592] as filed with the SEC for those years. The source of the data for 2001 is an attachment to minutes of the November 1, 2001, meeting of the Administrative Committee.[1593]

[1591] Committee on Education and the Workforce, United States House of Representatives, *The Enron Collapse and Its Implications for Worker Retirement Security,* H. Hrg. 107-42, at 100-101 (Feb. 7, 2002).

[1592] The Form 11-K is an annual report for employee stock purchase, savings, and similar plans, interests in which constitute securities registered under the Securities Act of 1933. The Form 11-K is required to be filed pursuant to section 15(d) of the Securities Act of 1933 even though the issuer of the securities offered to employees under the plan also files annual reports in accordance with the Securities Exchange Act of 1934. The Form 11-K is generally due to the Securities Exchange Commission within 180 days after the end of an ERISA plan's fiscal year. See 17 CFR 249.311.

[1593] *Enron Corp. Savings Plan Fund Information,* attachment to Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001854.

Table 4.–Distribution of Enron Savings Plan Investments by Type of Investment for 1996

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Short-Term Investments:		
Northern Trust Collective Stock Index Fund	7.8	
SEI Stable Asset Fund	0.0	
Total		7.8
Stock:		
Enron Corp. Common Stock	308.1	
Enron Corp. Cumulative Second Preferred Convertible Stock	41.2	
Enron Oil & Gas Company Common Stock	24.0	
Total		373.3
Investment Funds:		
Fidelity Investments Equity Income Stock	27.6	
Fidelity Investments OTC Fund	9.2	
Fidelity Investments Balanced Fund	3.7	
Fidelity Investments Growth & Income Fund	19.6	
Fidelity Investments Magellan Fund	15.9	
Fidelity Investments Growth Company Fund	16.3	
Fidelity Investments Overseas Fund	6.1	
Vanguard Growth Portfolio	2.4	
Vanguard Moderate Growth Portfolio	0.9	
Vanguard Conservative Growth Portfolio	1.4	
Total		103.1
Fixed Income Deposit Contracts:		
Allstate #GA-5826	4.4	
Canada Life Contracts #P-45770	12.3	
J.P. Morgan Enron-02	3.7	
John Hancock Mutual Life Insurance Co. #GAC 7374	7.1	
Lincoln National #GA-9597	7.2	
New York Life #GA-30282	4.9	
Peoples Security BDA00149TR-1	8.0	
Peoples Security BDA00149TR-2	3.9	
Peoples Security BDA00149TR-5	3.8	
Peoples Security BDA00437FR	8.3	
Principal Mutual #4-20383	4.3	
Protective Life #GA-1206	4.2	
Provident Life and Accident Insurance #627-5578	5.0	
Sun Life of Canada Insurance #S-0885-G	10.0	
Transamerica Occidental Life #51362	0.0	
Transamerica Occidental #51313-00	3.3	
Total		90.6

Note: Items may not sum to total due to rounding.

Source: 2000 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes, *available at* www.sec.gov.

Table 5.–Distribution of Enron Savings Plan Investments by Type of Investment for 1997

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Short-Term Investments:		
Northern Trust Collective Stock Index Fund	9.6	
SEI Stable Asset Fund	5.2	
Total		14.8
Stock:		
Enron Corp. Common Stock	276.9	
Enron Corp. Cumulative Second Preferred Convertible Stock	39.7	
Enron Oil & Gas Company Common Stock	28.4	
Total		345.0
Investment Funds:		
Fidelity Investments Equity Income Stock	39.7	
Fidelity Investments OTC Fund	10.7	
Fidelity Investments Balanced Fund	5.4	
Fidelity Investments Growth & Income Fund	31.8	
Fidelity Investments Magellan Fund	20.8	
Fidelity Investments Growth Company Fund	20.1	
Fidelity Investments Overseas Fund	8.3	
Vanguard Growth Portfolio	4.8	
Vanguard Conservative Growth Portfolio	1.5	
Vanguard Moderate Growth Portfolio	2.0	
Total		145.1
Fixed Income Deposit Contracts:		
Allstate #GA - 5826	4.7	
J.P. Morgan Enron-#02	3.8	
John Hancock Mutual Life Insurance Co. GAC # 7374	7.6	
New York Life #GA-30282	5.2	
Peoples Security BDA00149TR-1	8.0	
Peoples Security BDA00149TR-2	3.9	
Peoples Security BDA00149TR-5	3.8	
Peoples Security BDA00437FR	4.5	
Principal Mutual #4-20383	4.6	
Protective Life GA-#1206	4.2	
Provident Life and Accident Insurance #627-5578	5.2	
State Street Bank #97053	8.0	
Sun Life of Canada Insurance #S-0885-G	10.6	
Transamerica Occidental Life #51362	0.0	
Transamerica Occidental #51313-00	1.7	
Total		75.8

Note: Items may not sum to total due to rounding.

Source: 1997 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes, *available at* www.sec.gov.

Table 6.–Distribution of Enron Savings Plan Investments by Type of Investment for 1998

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Short-Term Investments:		
Morgan Stanley Stable Value II	6.2	
Northern Trust Collective Stock Index Fund	14.0	
SEI Stable Asset Fund	21.2	
Total		41.4
Stock:		
Enron Corp. Common Stock	311.1	
Enron Corp. Cumulative Second Preferred Convertible Stock	54.5	
Enron Oil & Gas Company Common Stock	38.9	
Total		404.5
Investment Funds:		
Fidelity Investments Equity Income Fund	45.1	
Fidelity Investments OTC Fund	17.0	
Fidelity Investments Balanced Fund	10.1	
Fidelity Investments Growth & Income Fund	55.9	
Fidelity Investments Magellan Fund	33.2	
Fidelity Investments Growth Company Fund	26.2	
Fidelity Investments Overseas Fund	9.4	
The Vanguard Group Growth Portfolio	9.6	
The Vanguard Group Conservative Growth Portfolio	3.1	
The Vanguard Group Moderate Growth Portfolio	3.4	
Total		213.0
Fixed Income Deposit Contracts:		
John Hancock Mutual Life Insurance Co. #GAC 7374	8.1	
John Hancock Mutual Life Insurance Co. #14447	6.0	
Peoples Security BDA00149TR-1	9.7	
Peoples Security BDA00149TR-8	3.9	
Peoples Security BDA00149TR-6	3.6	
Peoples Security BDA00437FR	4.8	
Peoples Security BDA00149TR-11	3.4	
Principal Mutual #4-20383	4.9	
Provident Life and Accident Insurance #627-5578	5.5	
State Street Bank 97-053B	7.8	
Sun Life of Canada Insurance #S-0885-G	11.1	
Transamerica Occidental Life #51362-00	0.0	
Transamerica Occidental Life #51313-00	1.9	
Total		70.7

Note: Items may not sum to total due to rounding.

Source: 1998 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes, *available at* www.sec.gov.

Table 7.–Distribution of Enron Savings Plan Investments by Type of Investment for 1999

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Short-Term Investments:		
Northern Trust Company Short-Term Investment Fund	8.8	
SEI Trust Company Stable Asset Fund	23.1	
Morgan Stanley Dean Witter Stable Value II	12.5	
Total		44.4
Stock:		
Enron Corp. common stock	662.1	
Enron Corp. Cumulative Second Preferred Convertible Stock	84.8	
Enron Oil & Gas Resources, Inc. Common Stock	25.2	
Charles Schwab Self-Directed Brokerage Account	16.1	
Total		788.2
Investment Funds:		
Fidelity Investments Equity Income Fund	43.2	
Fidelity Investments OTC Funds	43.4	
Fidelity Investments Balanced Fund	13.8	
Fidelity Investments Growth & Income Fund	55.0	
Fidelity Investments Magellan Fund	52.1	
Fidelity Investments Growth Company Fund	66.1	
Fidelity Investments Overseas Fund	15.5	
Morgan Stanley Dean Witter International Equity Portfolio	12.9	
Morgan Stanley Dean Witter Institutional Fund	69.1	
The Vanguard Group Growth Portfolio	59.5	
The Vanguard Group Conservation Growth Portfolio	15.1	
The Vanguard Group Moderate Growth Portfolio	56.5	
The Vanguard Group Index Trust 500 Portfolio	17.4	
The Vanguard Group Windsor II Fund	39.3	
T. Rowe Price Small Cap Fund	20.9	
PIMCO Total Return Fund	12.0	
PIMCO Low Duration Fund	10.2	
PIMCO Total	6.3	
UAM Trust Company Dwight Target 2 Fund	24.8	
UAM Trust Company Dwight Target 5 Fund	44.0	
Total		677.1
Fixed Income Deposit Contracts:		
John Hancock Mutual Life Insurance Co. GAC #7374	4.3	
John Hancock Mutual Life Insurance Co. #14447	6.4	
Principal Mutual Life Insurance Co. #4-20383	5.2	
Sun Life of Canada Insurance #S-0885-G, 5.42 percent	11.7	
Transamerica Occidental Life #51362-00, 6.10 percent	0.0	
Allstate Insurance Co. #5926P	4.3	
Allstate Insurance Co. #6229	6.0	
GE Life & Annuity Assurance Co. #3322	5.1	
John Hancock Mutual Life Insurance Co. #3322	5.0	
Monumental Insurance Co. #ADA00757FRP	6.6	
New York Life Insurance Co. #30505P	5.2	

Table 7.–Distribution of Enron Savings Plan Investments by Type of Investment for 1999

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
New York Life Insurance Co. #31036	32.7	
CDC Financial Synthetic #1032-01-P	0.7	
Transamerica Life Insurance Co. #76644-P	1.0	
Total		94.2

Note: Items may not sum to total due to rounding.

Source: 1999 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes, *available at* www.sec.gov.

Table 8.–Distribution of Enron Savings Plan Investments by Type of Investment for 2000

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Short-Term Investments:		
Northern Trust Company Short-Term Investment Fund	17.8	
SEI Trust Company Stable Asset Fund	18.3	
Morgan Stanley Dean Witter Stable Value II	13.4	
Total		49.5
Stock:		
Enron Corp. Common Stock	1,157.5	
Enron Corp. Cumulative Second Preferred Convertible Stock	158.9	
Enron Oil & Gas Resources, Inc. common stock	26.4	
Charles Schwab Self-Directed Brokerage Account	30.8	
Total		1,373.6
Investment Funds:		
Fidelity Investments Equity Income Fund	34.9	
Fidelity Investments OTC Funds	37.6	
Fidelity Investments Balanced Fund	12.2	
Fidelity Investments Growth & Income Fund	43.3	
Fidelity Investments Magellan Fund	46.5	
Fidelity Investments Growth Company Fund	84.0	
Fidelity Investments Overseas Fund	14.8	
Morgan Stanley Dean Witter International Equity Portfolio	11.7	
Morgan Stanley Dean Witter Institutional Fund	45.9	
The Vanguard Group Life Strategy Growth	44.9	
The Vanguard Group Conservation Growth Portfolio	12.6	
The Vanguard Group Moderate Growth Portfolio	41.1	
The Vanguard Group Index Trust 500 Portfolio	23.2	
The Vanguard Group Windsor II Fund	28.0	
T. Rowe Price Small Cap Fund	25.5	
PIMCO Total Return Fund II Institutional	8.0	
PIMCO Low Duration Fund	11.0	
PIMCO Total Return Fund	7.0	
UAM Trust Company Dwight Target 2 Fund	27.1	
UAM Trust Company Dwight Target 5 Fund	49.6	
Total		608.9
Fixed Income Deposit Contracts:		
John Hancock Mutual Life Insurance Co. #14447	6.8	
Canada Life Investment #P46067	12.5	
Canada Life Investment #P46058	13.8	
People's (Aegon) Life Co. #NDA0017SFR	10.2	
People's Benefit Life Investment #173FR	10.4	
Allstate Insurance Co. #5926P	4.6	
Allstate Insurance Co. #6229	6.5	
GE Life & Annuity Assurance Co. #3322	5.5	
John Hancock Mutual Life Insurance Co. #9600P	5.0	
New York Life Insurance Co. #31036	5.9	
CDC Financial Synthetic #1032-01-P	0.2	

Table 8.–Distribution of Enron Savings Plan Investments by Type of Investment for 2000

Investment	Year-End Value (millions of dollars)	Total Year-End Value (millions of dollars)
Transamerica Occidental Life Insurance Co. #76644-P	(0.4)	
State Street Bank Synthetic #97053	0.3	
Monumental Insurance Co. #BDA00390TR	(0.1)	
Total		81.2

Note: Items may not sum to total due to rounding.

Source: 2000 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes, *available at* www.sec.gov.

Table 9.–Enron Savings Plan Fund Information at October 26, 2001, as Reported at the November 1, 2001, Meeting of the Administrative Committee

Investment	Value (millions of dollars)	Total Value (millions of dollars)
Enron Corp. Stock	246.7	
EOG Resources	16.3	
Self-Directed Account	26.5	
SEI Trust Company Stable Asset Fund	223.5	
Fidelity Investments Equity Income Fund	31.4	
Fidelity Investments OTC Funds	22.8	
Fidelity Investments Balanced Fund	15.1	
Fidelity Investments Growth & Income Fund	36.7	
Fidelity Investments Magellan Fund	37.1	
Fidelity Investments Growth Company Fund	49.9	
Fidelity Investments Overseas Fund	10.4	
Morgan Stanley Dean Witter International Equity Portfolio	10.6	
Morgan Stanley Dean Witter Equity Growth	34.2	
The Vanguard Group Life Strategy Growth	36.3	
The Vanguard Group Conservation Growth Portfolio	9.9	
The Vanguard Group Moderate Growth Portfolio	36.2	
The Vanguard Group Index Trust 500 Portfolio	26.7	
The Vanguard Group Windsor II Fund	31.1	
T. Rowe Price Small Cap Fund	27.7	
PIMCO Total Return Fund II Institutional	17.0	
Total		946.1

Note: Items may not sum to total due to rounding.

Source: *Enron Corp. Savings Plan Fund Information*, attachment to Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001854.

Based on the data reported on the SEC Forms 11-K for the Enron Savings Plan for 1996 to 2000, as shown in Table 4 through Table 8, the portion of the assets under the Enron Savings Plan that was invested in Enron stock was 65 percent in 1996, 59 percent in 1997, 55 percent in 1998, 48 percent in 1999, and 62 percent in 2000.[1594] In 2000, these securities were valued at over $1.3 billion.[1595]

According to an attachment to the minutes of the November 1, 2001, meeting of the Administrative Committee, as of October 26, 2001, as shown in Table 9, 28 percent, or $246.7 million, of the assets under Enron Savings Plan were invested in Enron stock. Of this amount, $102 million was attributable to Enron's matching contribution and $144.7 million was attributable to participants' contributions.[1596]

Discussion of Issues

Enron stock was a significant portion of the assets held under the Enron Savings Plan in the period before Enron's bankruptcy. As a result, many Enron Savings Plan participants lost considerable amounts of retirement savings when Enron's stock price plummeted.[1597] There are a variety of factors which may have contributed to such significant investment in Enron stock, including plan design, a company culture that may have induced participants to invest in (and keep assets invested in) Enron stock, statements by high ranking Enron officials even as the Enron stock price fell regarding the bright future for Enron, a lack of understanding of the importance of diversification, and the actions (or inactions) of plan fiduciaries, including the Administrative Committee.

The design of the Enron Savings Plan is not atypical. Many defined contribution plans allow participants to direct the investment of their account balances, particularly elective deferrals under a 401(k) plan. Participants' varying tolerances for investment risk can be accommodated if plans offer a variety of investment options. It is not uncommon for stock of the employer sponsoring a plan to be offered as an investment option under a defined contribution plan.

[1594] For purposes of these calculations, because Enron Oil & Gas ("EOG") was established as a public company independent of Enron in 1999, investment in EOG is not considered in determining the overall amount of assets invested in Enron stock beginning in 2000. *See* Part II of Part Two of this Report; *also see* Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 45 (Feb. 5, 2002). Notwithstanding, EOG was retained as an investment option under the Enron Savings Plan. *Id.*

[1595] 2000 SEC Form 11-K for the Enron Corp. Savings Plan, Schedule of Assets Held for Investment Purposes.

[1596] *Enron Corp. Savings Plan Fund Information,* attachment to Minutes of the Meeting of the Administrative Committee (Nov. 1, 2001), EC000001854.

[1597] Many participants also lost their jobs. *Tittle v. Enron Corp.*, S.D. Texas, No. H-01-3913, First Consolidated and Amended Complaint (filed Apr. 8, 2002), at paragraph 20.

Some employers make all or part of their contributions to defined contribution plans in employer securities.[1598] Many employers favor contributing their stock to their defined contribution plans because newly-issued stock and treasury stock generally do not reduce the employer's cash flow. Many employers also believe that contributing company stock to a retirement plan places the stock in the hands of persons who are more likely to retain their shares through the company's downcycles and vote with current management. However, employees whose defined contribution account balances are heavily invested in employer securities are vulnerable to losing both their job and their retirement security if the company's fortunes decline. Employees often like the opportunity to have an ownership interest the company they work for, having the opportunity to share directly in profits of the company.

When an employee chooses to allocate a large percentage of his or her defined contribution plan assets to a single investment such as employer securities, that employee is generally assuming more risk than under a diversified asset allocation. The level of employee investment in Enron stock under the Enron Savings Plans and the losses in retirement savings resulting from the decline in Enron's stock price emphasizes the importance of prudent investment principles such as diversification. Diversification helps to mitigate investment risk by reducing excessive exposure to any one source.

The high concentration of Enron Savings Plan investments in Enron stock resulted from both employee investment choice and Enron's matching contributions being made in the form of Enron stock.[1599] Enron Savings Plan participants clearly did not invest their elective deferrals in Enron stock due to a lack of other alternatives. The Enron Savings Plan offered approximately 20 investment options other than Enron stock, consisting of a broad range of alternatives offering various risk and return characteristics, including a self-directed brokerage account. Overall losses experienced by Enron employees may have been limited if employees had diversified their elective deferral and after-tax contribution accounts and if the plan permitted them to diversify their company contribution accounts earlier than age 50. However, even if Enron Savings Plan participants had had this opportunity, it is not clear that many participants would have taken advantage of it, given the overall level of voluntary Enron Savings Plan investment in Enron stock. Current and former Enron employees interviewed by the Joint Committee staff demonstrated a tremendous loyalty to Enron, despite the bankruptcy and their own personal financial losses and experiences. While this loyalty certainly may not be universal, the degree to which many of the individuals interviewed by the Joint Committee staff still had faith in Enron was striking.

[1598] Many plans require that at least some portion of any employer contribution be in stock.

[1599] However, the high level of investment in Enron stock under the Enron Savings Plan was not altogether anomalous. One study of 401(k) plans with company stock showed that 25 out of 219 plans had more than 60 percent of their assets invested in company stock. *Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans,* DC Plan Investing (Institute of Management & Administration), at 1-2 (Dec. 11, 2001).

Investment in Enron stock by employees was generally encouraged by Enron, both through plan design and statements by management. During the period reviewed by the Joint Committee staff, Enron employees could acquire Enron stock through several company-sponsored arrangements, including the Enron Savings Plan, the Enron ESOP, and stock options. This variety of opportunities to purchase company stock is not uncommon among large employers.

In addition, Enron officials and Enron's "company culture" actively encouraged employee ownership of Enron stock, both through the Enron Savings Plan and in general. A central premise of Enron's philosophy seemed to be that all employees should be company owners.

Even as the price of Enron stock declined during 2001, management told employees of a bright future for Enron. For example, Mr. Lay was optimistic in his predictions for the future of Enron stock, even when an employee specifically asked about Enron stock in the context of the Enron Savings Plan. Similarly, Enron's Executive Vice President for Human Resources and Community Relations, Cindy Olson, said that employees should "Absolutely!" invest their contributions to the Enron Savings Plan in Enron stock. Even if management's positive predictions to employees about the future of Enron stock were not intended to be anything more than inspirational company pep talks, statements regarding Enron stock--especially in the context of the Enron Savings Plan--could have been understood by some employees to be an endorsement that a significant portion of their assets should be invested in Enron stock.

Additionally, the Administrative Committee may have played a role in the ultimate losses sustained by participants under the Enron Savings Plan. The Administrative Committee was the named fiduciary under the plan with responsibility for plan assets and had the power to direct the trustee, which held the plan assets.[1600] Under the Enron Savings Plan and the accompanying trust agreement, the Administrative Committee was responsible for selecting the investment alternatives available to participants in the Enron Savings Plan.[1601] While the trust agreement included Enron stock as an investment fund alternative, it also stated that the Administrative Committee had the authority to terminate any existing investment alternatives at any time.[1602] Notwithstanding, the Administrative Committee did not seem to view its role as including the obligation to review the suitability of Enron stock as an investment under the Enron Savings Plan. Minutes of Administrative Committee meetings show that the first time the Administrative Committee undertook such a review was at their meeting on November 1, 2001.

[1600] Sec. 15.2 of the Enron Savings Plan (July 1, 1999, restatement).

[1601] *Id.; see* Trust Agreement, Art. 4.

[1602] Trust Agreement, Art. 4; Under the Trust Agreement, the Committee has discretion to eliminate an investment option at any time. Additionally, the Committee is authorized to direct the Trustee as to the level of investment in Enron stock "as the Committee may deem appropriate." Enron Savings Plan, Article VIII, 7(j) (July 1, 1999, restatement).

If the Administrative Committee had acted sooner, losses under the Enron Savings Plan may have been limited. Provisions of the plan could be interpreted to give them the authority to act in this regard. These issues are currently the subject of litigation.[1603]

Recommendations

The Joint Committee staff believes that the main principle that can be drawn from the Enron experience is that the importance of diversification of retirement savings assets cannot be overemphasized. The Joint Committee staff recommends that that a variety of legislative changes should be made to reduce the likelihood that plan participants in plans that allow participant directed investments will have high concentrations of assets in a single investment.

The Joint Committee staff also recommends that plans should provide participants with investment education in a manner consistent with fiduciary standards. This should include. notices describing sound investment practices, with a focus on the importance of diversification. The notice might include, for example: (1) information regarding diversification of investments; (2) information on the essential differences, in terms of risk and return, of available investments, including stocks, bonds, mutual funds and money market investments; (3) information on how investment fees may affect the return on an investment; and (4) a description of the factors that may be relevant to determining the appropriate investment allocations under the plan, such as an individual's age and years to retirement.

The Joint Committee staff also recommends that plan participants should be notified when plan assets are over concentrated in a single asset. The notification could include a statement that the participant should review their plan investments to make sure they are properly diversified.

The Joint Committee staff recommends that plans should not be permitted to require that employee elective deferrals or after-tax contributions be invested in employer securities. In addition, plan participants should be given greater opportunity to diversify the investment of employer matching and certain other employer contributions made in the form of employer securities. In adopting specific rules, the Congress should consider the scope of any new diversification requirement as applied to employer contributions, for example, whether it should be limited to contributions related to elective deferrals (such as matching and nonelective employer contributions used to satisfy applicable nondiscrimination requirements) or whether it should have a broader application.

Finally, the Joint Committee staff recommends certain changes with respect to ERISA fiduciary rules. The experience at Enron pointed out the difficulties that may arise when plan

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[1603] Some participants in the Enron Savings Plan have alleged that the plan's administrators violated their fiduciary duties by allowing participants to continue investing in Enron stock and continuing to make matching contributions in Enron stock even after they knew or should have known that Enron faced difficult financial straits. As discussed above, several Enron Savings Plan participants have filed suit against Enron in federal court seeking relief for losses sustained to their balances under the Plan. *See* Part II.B.2., above.

fiduciaries play more than one role, particularly a role as a fiduciary and a role as an employee or executive of the employer. These two roles may conflict and cause confusion among plan participants. In addition, fiduciaries may not fully understand their dual roles.

In Enron's case, senior management, including Mr. Lay, made numerous statements in employee meetings and in electronic mail messages to employees regarding the future of Enron and the price of Enron stock. Most of these statements were not made specifically in the context of the Enron qualified plans; however, in at least two instances statements were made in the context of the Enron Savings Plan as to the appropriateness of Enron stock as an investment. In one case, Cindy Olson replied to the question "Should we invest all of our 401(k) in Enron stock?" by saying "Absolutely." In the other case in response to a question regarding the Enron Savings Plan and whether Enron would act to replace lost retirement benefits, Mr. Lay said "Enron stock, we'll bring it back."

There are legal and factual questions as to whether Ms. Olson and Mr. Lay were plan fiduciaries at the time of these statements and, if they were, whether they were acting in a fiduciary capacity. These issues are the subject of litigation.

Regardless of the outcome of this litigation, the statements were at best ill advised and certainly may have created the impression on the part of Enron Savings Plan participants that Enron stock was a safe investment. Corporate executives may generally be expected to present a positive view of the company, and should be free to do so. However, in the context of qualified retirement plans, the Joint Committee staff believes that senior executives, whether or not they are otherwise plan fiduciaries, should not make statements regarding the plan or plan investments, particularly employer securities, that are not in accord with generally accepted investment principles or general fiduciary standards. Thus, the Joint Committee staff recommends that fiduciary rules should apply to such statements.

Enron also demonstrates that plan fiduciaries may have difficulty determining what actions are consistent with their dual roles. The Congress should direct the Department of Labor to assist in this effort, including for example, making additional efforts to educate plan fiduciaries who are also employees regarding their duties, particularly in the context of real life situations. The materials could include, for example, a description of actions that might make a company executive a plan fiduciary, even if the individual is not named a fiduciary under plan documents.

While these recommendations may help prevent future losses such as those experienced by Enron employees, given the factors in Enron's case, particularly the culture that encouraged Enron stock ownership, it is not clear that the situation would have been any different if these measures had been in place prior to the bankruptcy. Further, Enron is not alone it the high concentration of investment in employer stock. A recent study of 219 large 401(k) plans found 25 plans that had over 60 percent of their assets invested in employer securities.[1604]

[1604] *See, Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans,* DC Plan Investing (Institute of Management & Administration), at 1-2 (Dec. 11, 2001).

Given these factors, the Joint Committee staff is concerned that, absent legal restrictions on the amount of employer securities that can be held in defined contribution plans, situations such as Enron's may occur again. Such restrictions would involve a major policy change from present law.

Enron also illustrates a general shift away from defined benefit plans toward defined contribution plans, particularly defined contribution plans that provide for participant directed investments. This shift can reduce retirement income security for plan participants, both because participants bear the risk of investment loss in defined contribution plans and because plan participants may not make appropriate investment decisions, regardless of the level of investment education they receive. Thus, the Congress may wish to consider broader approaches to addressing retirement income security under defined contribution plans. A range of options are possible; some suggestions that have been proposed by commentators include providing a Federal government guarantee of a minimum rate of return on defined contribution plan assets and placing some restrictions on the ability of plans to require that participants direct investments.

6. Allegations of misuse of benefit funds

Present Law

A number of present-law rules may be relevant with respect to misuse of pension plan assets by an employer or plan fiduciary.

Under the Code, a qualified retirement plan must be maintained for the exclusive benefit of the employees (the "exclusive benefit rule").[1605] In particular, the trust established in connection with the plan must prohibit the diversion of assets for purposes other than exclusive benefit of employees and their beneficiaries.[1606]

Through similar provisions of ERISA, the exclusive benefit rule applies to all employee benefit plans subject to ERISA without regard to their tax-qualified status. ERISA prescribes that plan fiduciaries shall discharge their duties with respect to a plan solely in the interest of the beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries.[1607]

ERISA also contains a "noninurement" rule which requires that, subject to certain exceptions, the assets of a plan shall never inure to the benefit of any employer and shall be held in a trust for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries.[1608] For this purpose, the assets of the plan include contributions that are withheld

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[1605] Sec. 401(a).

[1606] Sec. 401(a)(2).

[1607] ERISA sec. 404(a)(1).

[1608] ERISA sec. 403(c)(1).

from a participant's wages, which must be contributed to the plan as soon as they can reasonably be segregated from the employer's general assets.[1609] Employers who fail to promptly transmit participant contributions, and plan fiduciaries who fail to make diligent efforts to collect those amounts in a timely manner, may violate the requirement that plan assets be held in trust and may be engaging in prohibited transactions.[1610]

Under criminal law provisions of the U.S. Code, embezzlement, conversion, abstraction, or stealing of "any of the moneys, funds, securities, premiums, credits, property, or other assets of any employee welfare benefit plan or employee pension benefit plan, or any fund connected therewith" is a criminal offense punishable by fine, imprisonment, or both.[1611]

Factual Background[1612]

In early 2002, Robin Hosea, a former Enron contract employee and full-time employee, publicly alleged that payments were made from Enron's employee benefit funds for purposes unrelated to employee benefits. Specifically, Ms. Hosea alleged that, during 2000, approximately $15 million was improperly paid out of Enron Benefits Department accounts for purposes unrelated to employee benefits. She also claimed that her superiors at Enron told her that the payments were made to friends of executives and that she should not pursue the issue. Ms. Hosea's claims were reported in the national media, including in an interview on the television program, the *CBS Evening News*, which aired on February 4, 2002.

Because Ms. Hosea's allegations are under investigation by Federal government enforcement agencies, the Joint Committee staff has not attempted to independently investigate their veracity.

Ms. Hosea was hired by Enron in August 2000 on a contract basis to work in the Enron Benefits Department. Jobs she previously held with other employers included human resource, payroll, and accounting positions. In November 2000, Ms. Hosea was hired for the full-time position of Senior Benefits Specialist in the Enron Benefits Department. This was her only position while at Enron. While working for Enron, Ms. Hosea assisted with benefit compliance and budgeting work. Her specific responsibilities included accounting for employee benefit plans and the Benefits Department compliance and budgeting work.

Ms. Hosea reported to Enron's Senior Director of Benefits and one other manager at different times during her employment at Enron. Ms. Hosea took medical leave from Enron beginning May 24, 2001. She did not return to Enron and was laid off on December 5, 2001, as part of a general layoff following Enron's bankruptcy filing.

[1609] 29 C.F.R. 2510.3-102.

[1610] *See* Preamble to regulations at 29 C.F.R. 2510.3-102.

[1611] 18 U.S.C. sec. 664.

[1612] Unless otherwise indicated, the background information described herein is based on an interview of Ms. Robin Hosea conducted by Joint Committee staff on September 20, 2002.

According to Ms. Hosea, a general ledger account for the Enron Benefits Department was composed of several subaccounts, including subaccounts for medical benefits, dental benefits, life insurance, the Savings Plan, and vision benefits. Each month, Ms. Hosea would receive a statement of the account (including subaccounts) from Enron's Finance Department. The statement included a line for unallocated or unrecognized payments. These were payments that came out of the general account but were not assigned to a subaccount. According to Ms. Hosea, the unallocated payments were not initiated by the Benefits Department.

Sometime before taking medical leave, Ms. Hosea started to review the unallocated payments. She tracked two to three items that appeared in the accounts each month for three or four months running and determined that the payments had been made over a period of a few years. She obtained copies of the check requests but was unable to determine the purpose of the requisition. She showed them to her supervisor as well as the Benefit Department's administrative assistant, who did not recognize them. She also showed them to the Senior Director of Benefits, who did not recognize them. On instructions from the Senior Director of Benefits, Ms. Hosea contacted the person who approved the payments and learned that the payments originated in the Legal Department. According to Ms. Hosea, the Senior Director of Benefits told Ms. Hosea that she vaguely remembered the payments, and instructed Ms. Hosea to disregard the issue.

Additionally, in May 2001, Ms. Hosea identified a payment that originated with the Benefits Department and had the approval of the Department. A check in the amount of approximately $1,000 to $5,000 payable to an individual as a "consulting fee" was paid out of the medical or dental subaccount. Ms. Hosea's supervisor and the Benefits Department administrative assistant told Ms. Hosea that the fee was not unusual and that the payee was a friend of a highly-placed Enron executive. Ms. Hosea stated that she was again instructed to disregard the issue.

Former Enron Executive Vice President for Human Resources and Community Relations Cindy Olson, and former Enron Benefits Manager Mikie Rath were asked about Ms. Hosea's claims in hearings before the Senate Governmental Affairs Committee and the House Education and the Workforce Committee which were held in February 2002.[1613] Ms. Olson testified that she did not have first hand knowledge of Ms. Hosea's claims. Ms. Rath, who handled day-to-day administration of Enron's retirement plans, testified that no funds were diverted from the Savings Plan. Further, Ms. Rath explained that any payment from the Savings Plan trust would be reported in the plan's annual filing with the Department of Labor, the Form 5500, which requires a listing of payments from the plan. According to Ms. Rath, those audited financial statements appended to the Form 5500 showed no payments to individuals.

Ms. Hosea contacted the Department of Labor about these issues at the end of November or the beginning of December 2001. After contacting the Department of Labor, Ms. Hosea

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[1613] Committee on Governmental Affairs, United States Senate, *Retirement Insecurity: 401(k) Crisis at Enron*, S. Hrg. 107-378, at 59 (Feb. 5, 2002); Committee on Education and the Workforce, United States House of Representatives, *The Enron Collapse and Its Implications for Worker Retirement Security,* H. Hrg. 107-42, at 121-22 (Feb. 7, 2002).

claimed that she began to receive threats "almost daily" in the form of "threatening" phone calls and "hang up calls." Although she could not remember the callers' exact words, she perceived the threats to be physical. Ms. Hosea's stated that her husband answered a call to their home in which the caller admonished Ms. Hosea to "be quiet." Ms. Hosea also stated that she was being followed but did not report it to the police because she perceived "no real physical threat" or destruction of property.

Ms. Hosea feels that the threats she alleges she received were connected to her actions in relation to Enron. She claims that, at the time she received the calls, she had contacted the Department of Labor, but that contact had not been made public. Because of this timing, she believes that the threats could only have originated with Enron. She contacted the press about one month later.

Mr. Mark Lindsey, Enron's Vice President for Corporate Accounting and Planning told Joint Committee staff that he first learned of Ms. Hosea's allegations from a television program.[1614] He said that he recognized a schedule displayed during the program. The Corporate Accounting and Planning staff approached Mr. Lindsey about Ms. Hosea's allegations. They discussed her allegations and looked into them. According to the Mr. Lindsey, the allegations related to monthly reconciliations of benefits liabilities accounts for welfare benefits as well as for Enron's qualified plans. The staff, together with the Benefits Department, assembled an analysis of 14 to 15 subaccounts as part of their review.

In looking into her allegations, the Corporate Accounting and Planning staff did not speak directly with Ms. Hosea or attempt to contact her. Mr. Lindsey said there was "no reason" to contact her. He also said that the facts did not warrant speaking with anyone else about Ms. Hosea's claims. In the wake of Enron's bankruptcy filing, he explained, numerous allegations surfaced, many of which were sensationalized. Against this backdrop, he said, Ms. Hosea's claims were not compelling. Mr. Lindsey stated that he does not believe Ms. Hosea's claims that amounts allocated to other departments were diverted. He also said that there was no evidence that benefits funds were misused or that consulting fees were paid to friends of Enron executives but noted that consultants were occasionally retained by Enron in connection with special hiring initiatives.

Enron's Accounting Department responded to a subpoena issued by the Department of Labor in February 2002 in its investigation of Ms. Hosea's claims. According to Mr. Lindsey, the Department of Labor sent three or four investigators to audit Enron's employee benefits accounts during March or April of 2002. Mr. Lindsey and his staff spoke with the auditors and reviewed a reconciliation of employee benefits accounts with them.

Ms. Hosea's allegations were reported to the Administrative Committee of the Enron Qualified Plans by Enron's Director of Benefits at a February 12, 2002, meeting of the Committee. The Director of Benefits told the Committee that Ms. Hosea's allegations appeared to relate to accounting reserves for welfare benefit plans maintained by Enron, rather than assets

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[1614] Joint Committee staff interviewed Mr. Mark Lindsey, Enron's Vice President for Corporate Accounting and Planning, on January 23, 2002.

of any of the plans. He reported that the Department of Labor recently concluded a review of certain plans maintained by Enron and found no irregularities.

The Department of Labor is investigating Ms. Hosea's allegations.

Discussion of Issues

The allegations made by Ms. Hosea, if established as true, might have serious legal consequences for Enron officials, Enron itself, and certain Enron employee benefit plans. Specifically, violations of the exclusive benefit rule of the Code and ERISA could lead to plan disqualification or the imposition of prohibited transaction penalties. However, the allegations, even if true, do not necessarily represent an illegal or improper diversion of funds. Payments from unallocated subaccounts do not, taken alone, constitute improper or illegal payments.

Further, any violations of ERISA fiduciary responsibility provisions could result in the imposition of penalties by the Department of Labor. Criminal sanctions could be imposed. Additionally, participants, beneficiaries, or cofiduciaries could make legal claims against responsible persons for which they would be personally liable for plan losses or other court-ordered relief including punitive and extracontractual damages.[1615]

Based on interviews conducted by Joint Committee staff as well as the staff review of the media reports regarding Ms. Hosea's claims, there appear to be a variety of interpretations of what may have happened with respect to accounting practices of the Enron Benefits Department. The unallocated or unrecognized payments from the general ledger account identified by Ms. Hosea may have been legitimate entries consistent with the Benefits Department's bookkeeping practices. When she made the allegations in early 2001, Ms. Hosea was barely six months into her employment with Enron. It is possible that she was not yet familiar with the legitimate accounting practices of her employer.

When asked about her claims during an interview with Joint Committee staff, Ms. Hosea's answers to questions about the specifics of her allegations were vague. She stated that she could not recall the specific accounts from which the alleged improper payments were made nor could she recall the amounts involved. When asked about the threats she alleged were made against her, she could not provide any specific details.

Because there is an ongoing Federal investigation into Ms. Hosea's claims, the Joint Committee staff did not pursue Ms. Hosea's allegations issues further.

[1615] *See Mass. Mut. Life Ins. Co. v. Russell,* 473 U.S. 134 (1985).