

Follow the Leader: Does *Harris Trust* Follow *Peoria Union* Too Far?

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INTRODUCTION

To the already treacherous pathway¹ of pension benefits law under the Employee Retirement Income Security Act of 1974 (ERISA)² a new legal S-curve has been added by the Supreme Court in *John Hancock Mutual Life Insurance Co. v. Harris Trust & Savings Bank*.³ “Following the lead”⁴ of the Seventh Circuit Court of Appeals in *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*,⁵ the Court adopted a narrow reading of ERISA’s “guaranteed benefit policy” exception⁶ and affirmed the holding of

¹ See, e.g., *Supreme Court Adopts Common Law Test for Determining Who Is an Employee Under ERISA*, 1 ERISA LITIG. REP. (P-H) No. 7, at 3 (suggesting that ERISA cases are burdensome and that the Court delegates them to junior Justices); Harry V. Lamon, Jr., *Professional Money Managers: Fiduciary Responsibility Under ERISA*, 11 REAL PROP. PROB. & TR. J. 519, 519 (1976) (describing ERISA as a “legislative maze of often ill-defined, amorphous concepts of fiduciary responsibility”). Both of the sources above are cited in Scott V. Rozmus, Comment, *Insurers Beware: General Account Activities May Subject Insurance Companies to ERISA’s Fiduciary Obligations*, 88 NW. U. L. REV. 803, 806 n.26 (1994) (evidencing the commonness of “judicial disagreement and confusion over ERISA”).

² Federal legislation on pension benefits is found in the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461) (1988).

³ 114 S. Ct. 517 (1993).

⁴ *Id.* at 527 (“[W]e follow the Seventh Circuit’s lead, and seek guidance from this Court’s decisions construing the insurance policy exemption ordered in the Securities Act of 1933.” (citations omitted)) [*Harris IV*]; see *infra* note 16 for an explanation of the case numbering scheme.

⁵ 698 F.2d 320 (7th Cir. 1983) (Posner, J.).

⁶ 29 U.S.C. § 1101(b)(2) (1988). The statute states in pertinent part:

(2) In the case of a plan to which a guaranteed benefit policy is issued by an insurer, the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer. For purposes of this paragraph:

....

(B) The term “guaranteed benefit policy” means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.

Id. § 1101(b)(2)(B).

the Second Circuit Court of Appeals⁷ that the insurer/issuer⁸ of the contract at issue, Group Annuity Contract No. 50 ("GAC 50"),⁹ is an ERISA fiduciary as to its general account funds.¹⁰ An additional holding of this case deals with conflicts of law issues between state insurance law and ERISA¹¹ and their application in relation to ERISA's "preemption" and "savings" clauses.¹²

This Note seeks to chart the "odyssey"¹³ of *Harris Trust*. In particular, the focus will be on the Court's application of securities law's investment contracts analysis¹⁴ to pensions and as a related matter, the Court's stance as to statutory

⁷ *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 970 F.2d 1138 (2d Cir. 1992), *aff'd*, 114 S. Ct. 517 (1993).

⁸ The term "insurer/issuer" is original to the author, to the best of his knowledge, and is purposefully drawn to highlight the intermingled securities law issues present in this case. For a suggestion that pension plans be governed by securities law regulation, see Keir N. Dougall, Note, *Augmenting ERISA with Market Discipline: Transforming Pension Plan Interests into Securities*, 24 U. MICH. J.L. REF. 709 (1991).

⁹ *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 722 F. Supp. 998, 999 (S.D.N.Y. 1989), *aff'd in part and rev'd in part*, 970 F.2d 1138 (2d Cir. 1992), *aff'd*, 114 S. Ct. 517 (1993).

¹⁰ "General account funds" or simply "general account" refers to the general corporate assets of the insurer, into which revenues are credited and from which liabilities and expenses are paid. See Stephen H. Goldberg & Melvin S. Altman, *The Case for the Nonapplication of ERISA to Insurers' General Account Assets*, 21 TORT & INS. L.J. 475, 475 (1986) (defining "general account" as general corporate assets); *id.* at 476 n.8 and accompanying text (explaining the nature of the corporate general assets).

¹¹ See *Harris IV*, 114 S. Ct. at 525.

¹² *Id.* at 525-26. On one hand, ERISA preempts state law in the area of pension benefits. This famous ERISA "preemption" clause states in pertinent part, that the statute "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. § 1144(a) (1988). At the same time, Congress also enacted the ERISA "savings" clause, which removes "the business of insurance" from federal ERISA preemption, thereby leaving such items to state regulation. The savings clause states that ERISA "shall [not] be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities." *Id.* § 1144(b)(2)(A). For competing viewpoints on ERISA preemption in the insurance context, compare Goldberg & Altman, *supra* note 10, at 477 (discussing the variance of standards of care between ERISA and state insurance law and concluding that "the application of ERISA[] . . . would place an insurer in an untenable position of divided loyalties") with Rozmus, *supra* note 1, at 824 (arguing that insurers "cannot use state insurance laws to escape . . . ERISA").

¹³ WEBSTER'S NEW WORLD DICTIONARY (3d College ed. 1988) defines an "odyssey" as "any extended wandering or journey." The term originates from Homer's epic poem detailing the wanderings of Odysseus, a Greek hero who literally travels to hell and back home following the fall of Troy. HOMER, ODYSSEY (Doubleday & Co. 1961). This term is chosen to symbolize the complexity of the case's background.

¹⁴ Section 3(a)(8) of the Securities Act of 1933 provides a class exemption from its

construction in this area.

Part I of this Note briefly outlines some basic concepts of ERISA. Part II reviews the historical background of *Harris Trust*, seeking to reconstruct various facts scattered—not unlike ERISA’s provisions in the *United States Code*¹⁵—across four opinions.¹⁶ Part III considers the Supreme Court decision and focuses on the Court’s discussion of the method and standard for determining the scope of the guaranteed benefits policy exemption.¹⁷ Part IV

registration requirements under § 5 for “[a]ny insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner, bank commissioner, or any agency or officer performing like functions, of any State or Territory of the United States or the District of Columbia” 15 U.S.C. § 77c(a)(8) (1994). For a discussion of the insurance and annuity exemption in securities law, see LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* § 3A.1.f (1993).

¹⁵ ERISA tax issues are administered by the Treasury Department, whereas fiduciary and other aspects are regulated by the Department of Labor. DAN M. MCGILL & DONALD S. GRUBBS, JR., *FUNDAMENTALS OF PRIVATE PENSIONS* 54 (6th ed. 1989); *see also* Rozmus, *supra* note 1, at 807 n.30.

¹⁶ The opinions include two from the district court, one from the Second Circuit Court of Appeals, and of course, the Supreme Court’s opinion. While this Note will generally refer in text to the Supreme Court’s decision as simply *Harris Trust*, for specific references it follows the Second Circuit’s sequential numbering method, *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 970 F.2d 1138, 1140 (2d Cir. 1992), *aff’d*, 114 S. Ct. 517 (1993), and extends that numbering scheme to include both the court of appeals and Supreme Court opinions, to wit:

Harris I: *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 722 F. Supp. 998 (S.D.N.Y. 1989) (granting partial summary judgment as to ERISA fiduciary claims), *aff’d in part and rev’d in part*, 970 F.2d 1138 (2d Cir. 1992), *aff’d*, 114 S. Ct. 517 (1993);

Harris II: *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 767 F. Supp. 1269 (S.D.N.Y. 1991) (granting summary judgment to defendant insurer on plaintiff trustee’s common law and contract claims and dismissing the case), *aff’d*, 970 F.2d 1138 (2d Cir. 1992), *aff’d*, 114 S. Ct. 517 (1993);

Harris III: *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 970 F.2d 1138 (2d Cir. 1992) (reversing in part as to ERISA fiduciary claims), *aff’d*, 114 S. Ct. 517 (1993);

Harris IV: *John Hancock Mut. Life Ins. Co. v. Harris Trust & Sav. Bank*, 114 S. Ct. 517 (1993).

Technically, there is even a *Harris V*. It relates solely to discovery issues and for that reason is excluded from further discussion in this Note. *Harris Trust & Sav. Bank v. John Hancock Mut. Life Ins. Co.*, 1994 U.S. Dist. LEXIS 8771 (S.D.N.Y. June 28, 1994).

¹⁷ This Note merely introduces the notion of the related issues of the state-federal coordination or preemption under ERISA, deeming that topic worthy of its own Note. *See supra* note 12.

analyzes the use of securities law concepts and the Court's approach to statutory construction in this case. Part V presents the administrative response to the case.¹⁸

I. BACKGROUND TO THE AREA

It is beyond the scope of this Note to examine comprehensively employee benefits law,¹⁹ ERISA's workings as the federal statutory regulator of such benefits,²⁰ or the wide realm of funding arrangements available to pension plans.²¹ Nevertheless, familiarity with the "basics" of each of these areas is essential to an understanding of *Harris Trust*.

A. Pension Benefits Before ERISA—Trust and Insurance Law

Employee pension benefits originated approximately a century ago.²² Pensions originally were viewed as mere employer gratuities, and plans often stated that no employee rights were created by the plans.²³ Although such notions soon changed,²⁴ the pre-ERISA legal landscape was a disunified patchwork of trust and insurance law.²⁵ This situation arose due to the employers' use of both trust and annuity contract forms for the administration of pension plans.²⁶ The main differences²⁷ between these two types of funding

¹⁸ See 60 Fed. Reg. 35925 (1995).

¹⁹ "Employee benefits law" includes not only retirement benefit plans, often called "pension plans," but also health care, disability, and accident benefits. See BARBARA J. COLEMAN, PRIMER ON ERISA at v (2d ed. 1987).

²⁰ As to retirement benefits plans, the coverage of ERISA generally includes plans by private employers and excludes plans by public employers and churches. 29 U.S.C. § 1003 (a), (b) (1988). For an overview of ERISA's scope and structure, see MCGILL & GRUBBS, *supra* note 15, at 54–58; COLEMAN, *supra* note 19, at 1–9.

²¹ Messrs. McGill and Grubbs, for example, distinguish first between "allocated" (contributions are credited to individual accounts for each employee) and "unallocated" (contributions are credited to a pooled account) funding instruments. MCGILL & GRUBBS, *supra* note 15, at 525. The *former* are not relevant to this Note. Within the subset of "allocated" funding arrangements, the commentators distinguish between "unallocated group annuity contracts" and "trust" arrangements. *Id.* at 550. Unallocated group annuity contracts, or what are generally referred to in the industry as "deposit administration contracts," are the topic of this Note. For more on deposit administration contracts, see *id.* at 551–64. For more on trust arrangements, see *id.* at 565–74.

²² See *id.* at 16.

²³ *Id.*

²⁴ See *id.* at 17–21 for a discussion of the sociological and economic theories underlying the pension movement.

²⁵ See *id.* at 47.

²⁶ The Internal Revenue Service has required the use of the "trust" form as a

vehicles consist of the separation of assets (trusts) versus the pooling or commingling of assets (insurance),²⁸ and duties based on fiduciary principles (trusts) versus duties based on contract (insurance).²⁹ In this state of affairs, “the reach of the laws and the scope of the remedies were considered by most legal experts to be inadequate for pension plans Thus, there was no single law or body of law designed to regulate the totality”³⁰ of private pensions.

B. ERISA—Federal Law Unifies the Law of Employee Benefits

The use of private pensions has grown dramatically in the twentieth century.³¹ Response to this growth, coupled with concern over plan mismanagement,³² resulted in the enactment of ERISA³³ in order “to protect

qualification for tax benefits since 1921. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1107–08 (1988). However, tax law excluded from the trusteeship requirement those plans funded exclusively by insurance annuity contracts. *Id.* at 1108 n.14.

²⁷ See generally Goldberg & Altman, *supra* note 10, at 478–79 (comparing trust and insurance forms).

²⁸ Under common trust law, trustees were required to separate assets held in trust both from the trustee's own assets and from the assets of other trusts. RESTATEMENT (SECOND) OF TRUSTS § 179 (1959). Under insurance contracts, other than “separate accounts” functioning similarly to the trusts rule, contributions are commingled with the insurer's general assets. Goldberg & Altman, *supra* note 10, at 479. Professors Fischel and Langbein explain the distinction as follows: “Unlike the stakeholding trustee who must segregate the transferred trust property, the life insurance company is directly liable for the benefit levels that it guarantees. In lieu of the fiduciary safeguards of trust law, the insurance beneficiary has certain regulatory safeguards that reinforce market discipline in the industry.” Fischel & Langbein, *supra* note 26, at 1114 n.42 (citation omitted).

²⁹ For a presentation of trust law fiduciary duties, see Fischel & Langbein, *supra* note 26, at 1113–17 (explaining a trustee's duties of stringent loyalty, prohibition against self-dealing, regulation of compensation, nondelegation, and prudence in investing and administration). Under an insurance arrangement, contractual promises or “guarantees” and state insurance regulations govern the relationship. Goldberg & Altman, *supra* note 10, at 476 (noting the use of contractual promises); *Id.* 477 (explaining that state insurance fiduciary regulations are “designed to assure that an insurer maintain equity among its various constituencies”).

³⁰ MCGILL & GRUBBS, *supra* note 15, at 48.

³¹ From nonexistence approximately 115 years ago, *supra* note 22, private pension plans in the United States grew to include \$1.6 trillion dollars in assets and 76.6 million participants by 1987. HUMAN RESOURCES DIVISION, GENERAL ACCOUNTING OFFICE, ENFORCEMENT OF ERISA PROVISIONS, REPORT TO SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS 1, 2 (1989), cited in Rozmus, *supra* note 1, at 804 n.5.

³² See MCGILL & GRUBBS, *supra* note 15, at 51–54 (describing the “gestation” of ERISA); 120 CONG. REC. 29,949 (1974) (“[ERISA] will eliminate the inequities and aberrations in our private retirement system”) (statement of Sen. Bentsen).

. . . the interests of participants in employee benefit plans"³⁴

ERISA's main features include reporting and disclosure requirements to plan participants,³⁵ participation and vesting requirements,³⁶ funding requirements,³⁷ and penalty and enforcement procedures.³⁸ Three concepts fundamental to ERISA are "plan assets,"³⁹ ERISA fiduciaries,⁴⁰ and the fiduciary's general standard of care and specific "prohibited transactions" rules.⁴¹ These concepts all harken back to the trust law side of pensions.⁴² They can be visualized in terms of a garden (assets), its caretaker/gardener (fiduciaries), and the fences around the garden (general fiduciary duties and specific prohibited transactions).

1. *The Garden: ERISA's "Plan Assets"*

Determining what res or "things"⁴³ are included in a trust or an ERISA

³³ Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1001-1461) (1988).

³⁴ 29 U.S.C. § 1001(a), (b). *See also* Massachusetts v. Morash, 490 U.S. 107, 109 (1989) (stating that ERISA was enacted "to safeguard employees from the abuse and mismanagement of funds that had been accumulated to finance various types of employee benefits").

³⁵ 29 U.S.C. §§ 1021-1031 (1988 & Supp. 1993). *See generally* MCGILL & GRUBBS, *supra* note 15, at 62-67.

³⁶ 29 U.S.C. §§ 1051-1061; *see also* 26 U.S.C. § 411 (1988) (listing the Internal Revenue Code provisions for minimum vesting standards). *See generally* MCGILL & GRUBBS, *supra* note 15, at 154-61.

³⁷ 29 U.S.C. §§ 1081-1086; *see also* 26 U.S.C. § 412 (listing the Internal Revenue Code provisions for minimum funding standards).

³⁸ 29 U.S.C. §§ 1131-1134 (1988 & Supp. 1993) (prescribing criminal penalties, authorizing civil enforcement, requiring claims procedures, and providing investigative authority to the Department of Labor); *id.* § 1140 (protection for whistleblowers); *id.* § 1109 (prescribing liability for breach of fiduciary duties).

³⁹ *See infra* notes 43-52 and accompanying text.

⁴⁰ 29 U.S.C. §§ 1101-1104.

⁴¹ *Id.* § 1104 (defining the general fiduciary standard of care); *id.* §§ 1106-1107 (designating specific prohibited transactions); *see also id.* § 1108 (authorizing the Department of Labor to promulgate exemptions from the prohibited transactions).

⁴² Professors Fischel and Langbein observe that the "heart" of ERISA fiduciary law consists of the traditional standards of care found in the common law of trusts. Fischel & Langbein, *supra* note 26, at 1108. They also note: "The drafters of ERISA intended to 'apply rules and remedies similar to those under traditional trust law.'" *Id.* (quoting CONFERENCE REPORT ON HR 2, PENSION REFORM, H.R. REP. NO. 93-1280, 93d Cong., 2d Sess. 295, reprinted in 3 LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, 94th Cong., 2d Sess. 4277, 4562 (1976)).

⁴³ "Res" (literally, "thing") is the "subject matter of a trust or will." BLACK'S LAW DICTIONARY 1304 (6th ed. 1990). The subject matter of a trust could include real and

plan is like a caretaker/gardener determining what is to be planted in the garden. The gardener must know what will be planted in the garden before the garden can be nurtured. This is also the case with ERISA—coverage under its fiduciary rules extends only to plan assets.⁴⁴ Phrased another way: If a “thing” is *not* a “plan asset,” it is not included in ERISA’s fiduciary provisions.⁴⁵

The problem with the term “plan asset” is that ERISA provides no direct definition of the term.⁴⁶ Rather, Congress carved out two exclusions to the applicability of the fiduciary rules.⁴⁷ The first exclusion relates to securities issued to a pension plan by a registered investment company;⁴⁸ the other, to guaranteed benefit policies issued to a plan by an insurance company.⁴⁹ In both cases, plan assets include the thing issued (the security or policy itself), “but shall not, solely by reason of” issuance, include any assets of the issuer/insurer.⁵⁰ The statute further defines “insurer” in terms of the

personal property of almost any sort. GEORGE L. CLARK, PRINCIPLES OF EQUITY § 269 (1937).

⁴⁴ See 29 U.S.C. § 1002(21)(A) (1988) (defining a “fiduciary” in terms of involvement with plan assets); Rozmus, *supra* note 1, at 805 (discussing ERISA’s function-based approach to the definition of a fiduciary).

Each substantive “part” of ERISA begins with a “coverage” section. See, e.g., 29 U.S.C. § 1051 (1988 & Supp. 1993) (participation and vesting); *id.* § 1081 (funding); *id.* § 1101 (fiduciary rules). The references in § 1101(a) (“This part shall apply”) and § 1101(b) (“For purposes of this part”) both point to the fiduciary rules.

⁴⁵ See *infra* part II.B.2.

⁴⁶ *Harris IV*, 114 S. Ct. at 524 (noting that “[t]he ‘assets’ of a plan are undefined except by exclusion”).

In both the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress provided detailed definitions of “security.” See 15 U.S.C. § 77b(1) (1994) (1933 Act definition); 15 U.S.C. § 78c(a)(10) (1934 Act definition). However, even that approach did not thwart substantial litigation as to what types of interests are securities. For an authoritative presentation of the statutory, regulatory, and case law components pertaining to the determination of a security, see LOSS & SELIGMAN, *supra* note 14, ch.3.A.1.

⁴⁷ See 29 U.S.C. § 1101(b)(1).

⁴⁸ *Id.*

⁴⁹ *Id.* § 1101(b)(2).

⁵⁰ The language of each is parallel. Compare the relevant words of the subsections:

(b)(1) . . . the assets of such plan shall be deemed to include such security but shall not, solely by reason of such investment, be deemed to include any assets of such investment company.

(b)(2) . . . the assets of such plan shall be deemed to include such policy, but shall not, solely by reason of the issuance of such policy, be deemed to include any assets of such insurer.

Id. § 1101(b).

qualifications of an insurer to do business in a state⁵¹ and, of course, provides the definition of guaranteed benefit policy at issue in *Harris Trust*.⁵²

2. *The Caretaker/Gardeners: ERISA Fiduciaries*

A trustee, as caretaker of the garden of assets, assumes the legal role of “fiduciary.”⁵³ By defining “fiduciaries” in terms of function,⁵⁴ ERISA includes a wider scope of persons than that which is included under trust law.⁵⁵ ERISA requires a plan to have one or more “named fiduciaries” possessing “authority to control and manage the operation and administration of the plan.”⁵⁶ Beyond this, however, several groups of persons are fiduciaries, including investment advisors,⁵⁷ plan administrators with “any discretionary authority or discretionary responsibility,”⁵⁸ and any person who “exercises *any discretionary* authority or discretionary control” or “*any authority* or control respecting management or disposition of its assets.”⁵⁹ Thus, the list of potential

⁵¹ *Id.* § 1101(b)(2)(A).

⁵² *Id.* § 1101(b)(2)(B) (1988). For a quotation of this subsection, see *supra* note 6.

⁵³ The noun “fiduciary” is defined as someone “having duty, created by his undertaking, to act primarily for another’s benefit in matters connected with such undertaking.” BLACK’S LAW DICTIONARY 625 (6th ed. 1990); see also Fischel & Langbein, *supra* note 26, at 1114–15 (explaining that the strict duties of a trustee emanate from the trustee’s “substitute” function).

⁵⁴ The relevant language of ERISA states:

[A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A) (1988). For an extended discussion of ERISA fiduciary status and its implications, see generally William L. Scogland, *Fiduciary Duty: What Does It Mean?*, 24 TORT & INS. L.J. 803 (1989).

⁵⁵ Scogland, *supra* note 54, at 803 (noting that Congress clearly intended the term “fiduciary” to be construed broadly).

⁵⁶ 29 U.S.C. § 1102(a)(1) (1988).

⁵⁷ *Id.* § 1002(21)(A)(ii).

⁵⁸ *Id.* § 1002(21)(A)(iii).

⁵⁹ *Id.* § 1002(21)(A)(i) (emphasis added). One commentator notes that the lack of the term “discretionary” in the latter part of subsection (i) of the definition evidences legislative desire for a very broad inclusion wherever “assets” are involved. See Rozmus, *supra* note 1, at 805 n.19 and accompanying text.

fiduciary gardeners in the ERISA context can be very long and complex.⁶⁰

3. *Fences Around the Garden: Fiduciary Duties and Prohibited Transactions*

Similar to trust law,⁶¹ ERISA sets an exacting level of duty for fiduciaries. The basic rule⁶² under ERISA section 404(a)(1) requires a fiduciary to act “solely in the interest of participants”⁶³ and for their “exclusive benefit,”⁶⁴ according to an objective “prudent man” test,⁶⁵ by diversifying investments so as to minimize large losses, unless it is prudent not to do so,⁶⁶ and in accord with the terms of the plan.⁶⁷ The main focus of this “solely-in-the-interest/exclusive-benefit” provision, called the exclusive benefit rule,⁶⁸ mirrors trust law’s key rule, the duty of loyalty.⁶⁹ ERISA further emphasizes the exclusive benefit rule in the so-called “noninurement rule,”⁷⁰ which states that, subject to certain exceptions relating to insured plan termination, assets must not inure to the benefit of employers and must benefit only the recipients of benefits.

⁶⁰ For a discussion of some of the problems of applying the fiduciary status broadly in the employee benefits arena, see Fischel & Langbein, *supra* note 26, at 1117–22.

⁶¹ See *id.* at 1108–10 (comparing generally ERISA fiduciary duties with the duties of common-law trustees); see also *supra* notes 28–29.

⁶² Professors Fischel and Langbein refer to 29 U.S.C. § 1104(a) as the “heart” of ERISA’s fiduciary rules. Fischel & Langbein, *supra* note 26, at 1108. For more on ERISA fiduciary duties, see Scogland, *supra* note 54, at 818–21 nn.100–13 and accompanying text.

⁶³ 29 U.S.C. § 1104(a)(1)(A) (1988).

⁶⁴ *Id.* § 1104(a)(1)(A)(i).

⁶⁵ The statute reads:

[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims

Id. § 1104(a)(1)(B) (1988); cf. RESTATEMENT (SECOND) OF TRUSTS § 174 (1959) (prudent administration).

⁶⁶ 29 U.S.C. § 1104(a)(1)(C); cf. RESTATEMENT (SECOND) OF TRUSTS § 227 (1959) (prudent investment).

⁶⁷ 29 U.S.C. § 1104(a)(1)(D).

⁶⁸ See Fischel & Langbein, *supra* note 26, at 1108.

⁶⁹ *Id.*; cf. RESTATEMENT (SECOND) OF TRUSTS § 170(1) (1959) (duty of loyalty).

⁷⁰ 29 U.S.C. § 1103(c) (1988). For more on the noninurement rule, see Fischel & Langbein, *supra* note 26, at 1149–54 (discussing the workings of the noninurement rule in certain termination situations).

ERISA goes beyond these general standards, however, and sets additional limitations (fences around the garden) in the form of prohibited transaction rules.⁷¹ On one hand, these rules flatly prohibit certain types of transactions⁷² between the plan, *its assets*, and a widely-defined group of “parties in interest.”⁷³ Additional rules relating more generally to self-dealing, or conflicts of interest transactions between the plan and fiduciaries, further fence in the garden of assets.⁷⁴ Notably, a fiduciary may not “deal with the assets of the plan in his own interest or for his own account”⁷⁵ Absent an exemption from Congress or the Department of Labor,⁷⁶ any such transaction—even though beneficial to the plan—is banned.⁷⁷ Prohibited transactions have particular application in employee benefit insurance plans such as in *Harris Trust*, since countless transactions may fall outside the garden fence of what is permissible.

In summary, the fiduciary provisions of ERISA provide an intricate system for protecting employee benefits. With this system in mind, it is next appropriate to turn to the history of the *Harris Trust* case.

II. BACKGROUND TO *HARRIS TRUST*

This Part presents the historical background to the case. Section A focuses on the factual history. Section B turns to the lower court decisions in *Harris Trust*.

A. *Developments Between the Parties Prior to Litigation*

The pre-litigation history of *Harris Trust* spans several decades and

⁷¹ See 29 U.S.C. § 1106. For a presentation of the prohibited transactions rules, see Scogland, *supra* note 54, at 823–24. For more on the implications of the prohibited transactions rules in the insurer context, see Goldberg & Altman, *supra* note 10, at 477.

⁷² See 29 U.S.C. § 1106(a)(1)(A)–(E) (prohibiting, *inter alia*, the sale/exchange/lease of property, lending of money, extension of credit, transfer of any plan assets, or the acquisition of certain real property or securities of the employer).

⁷³ See *id.* § 1002(14) (defining “party in interest” to include, *inter alia*, the fiduciary, providers of services to the plan, employers, relatives of these three groups, employee organizations connected with the plan, and certain majority stockholders of entities related to any of these groups).

⁷⁴ See *id.* §§ 1106(b)–(c) (prohibiting self-dealing, dealing with parties of adverse interest, and certain stock or real property transactions).

⁷⁵ *Id.* § 1106(b)(1).

⁷⁶ See *id.* § 1108 (authorizing the Secretary of Labor to establish regulations providing exemptions from the operation of the prohibited transaction rules).

⁷⁷ See Scogland, *supra* note 54, at 824 (noting that even beneficial transactions are prohibited).

contractual amendments. It is helpful to divide this era into four phases: (1) the original agreement; (2) the 1968 amendment; (3) the 1977 amendment; and (4) the period from 1977 until 1983, when litigation commenced.

1. *The Original Contract (1941-67)*

In 1941, the Sperry Corporation⁷⁸ contracted with John Hancock for the provision of retirement benefits for Sperry employees.⁷⁹ The contract, known as Group Annuity Contract No. 50 ("GAC 50"),⁸⁰ was a deferred annuity contract⁸¹ under which Sperry purchased, through annual premiums,⁸² deferred annuities for employees which Hancock would pay on upon an employee's retirement.⁸³

2. *The IPG Amendment (1968-77)*

The first relevant change⁸⁴ in the Hancock/Sperry contract occurred in 1968,⁸⁵ when the policy changed to a Retrospective Immediate Participation Guarantee ("retro-IPG") form.⁸⁶ Under this arrangement, two bookkeeping accounts recorded debits against the plan (called Liabilities of Fund or "LOF")⁸⁷ and credits to the plan (called Pension Administration Fund or "PAF").⁸⁸ Credits to the PAF came from employer contributions and from the plan's pro rata "participation"⁸⁹ in the insurer's net positive experience.⁹⁰ In

⁷⁸ In 1986, the Sperry Corporation and the Burroughs Corporation merged to form the Unisys Corporation, the successor to Sperry-Rand or "Sperry" throughout the opinions. *Harris I*, 722 F. Supp. at 999 n.1.

⁷⁹ *Id.*

⁸⁰ "Harris Trust is the present trustee of the [pension] and the ultimate successor to Sperry's rights as contractholder of GAC 50." *Harris III*, 970 F.2d at 1140.

⁸¹ A deferred annuity contract is an "agreement in which the terms require payment to begin after a certain period of time has elapsed" BLACK'S LAW DICTIONARY 421 (6th ed. 1990). An annuity is the "right to receive fixed, periodic payments, either for life or for a term of years." *Id.* at 90. See generally MCGILL & GRUBBS, *supra* note 15, at 545-49 (explaining the workings of group deferred annuity contracts).

⁸² *Harris II*, 767 F. Supp. at 1272.

⁸³ *Harris I*, 722 F. Supp. at 999-1000.

⁸⁴ *Harris II*, 767 F. Supp. at 1272 n.2.

⁸⁵ *Harris III*, 970 F.2d at 1141.

⁸⁶ For more on this type of contract, see MCGILL & GRUBBS, *supra* note 15, at 562-64; Goldberg & Altman, *supra* note 10, at 478-82.

⁸⁷ The Supreme Court describes an LOF simply as a "liabilities" account. *Harris IV*, 114 S. Ct. at 522.

⁸⁸ The Court describes a PAF as an "assets" account. *Id.*

⁸⁹ See *Harris I*, 722 F. Supp. at 1000. Greatly simplified, "participation" works as follows: Insurer calculates its overall investment experience, prorates the plan's share of

reality this was a minor change, because Hancock had previously “distributed such net experience to the contract holder as dividends.”⁹¹ Conversely, Hancock effectively guaranteed that the PAF would not drop below its January 1, 1968 level, thus protecting the fund from erosion due to negative insurer experience.⁹² This was required because preexisting annuities were “technically canceled,”⁹³ and the assets supporting them deposited into the PAF account.⁹⁴ Hancock further guaranteed the payment of annuities to employees “once an employee’s retirement annuity [was] established.”⁹⁵

The LOF documented not only present liabilities, but was also “the contractual reserve for the possible future purchase of annuities for the benefit obligations guaranteed by Hancock.”⁹⁶ The court in *Harris I* explained the provision of new benefits and the interrelation of the two accounts as follows:

[U]pon an eligible employee’s retirement Hancock would determine, pursuant to rate tables contained in GAC 50, the amount by which the . . . LOF would increase if that portion of the employee’s retirement benefit accruing in the period after January 1, 1968 were to be guaranteed by Hancock. If GAC 50’s PAF balance exceeded the contract’s Minimum Operating Level (“MOL”) (equal to 105% of its LOF), based upon this increased LOF, Hancock would guarantee the payment of the additional benefits. If the amount of the PAF fell below the amount of the LOF . . . , Hancock could ask Sperry for a contribution.⁹⁷

The MOL not only determined in part the need for contribution, but also affected contract termination.⁹⁸ Termination would occur if Sperry failed to “maintain” the PAF at or above the 105% MOL level. Upon termination, the

participation in such experience, and then compares that amount with the contract’s stated interest and expense rates. If the prorated net actual experience exceeds the contractually projected rate, the appropriate credit is made to the PAF. *See* Goldberg & Altman, *supra* note 10, at 480. For a more technical explanation of the same, see MCGILL & GRUBBS, *supra* note 15, at 553–55.

⁹⁰ *Harris I*, 722 F. Supp. at 1000. “Net positive experience” takes into account positive factors such as investment/asset income and lower than anticipated mortality experience, and negative factors (for example, expenses, investment non-successes, and higher than expected policy payouts). *See* Goldberg & Altman, *supra* note 10, at 480.

⁹¹ *Harris II*, 767 F. Supp. at 1272 n.3.

⁹² *See Harris I*, 722 F. Supp. at 1000 (explaining how the fund would not drop below 1968 level); *Harris III*, 970 F.2d at 1141 (restating the effective guarantee of non-loss).

⁹³ *Harris III*, 970 F.2d at 1141.

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Harris I*, 722 F. Supp. at 1000–01 (footnotes omitted).

⁹⁸ *Id.* at 1001.

contract would revert to the prior deferred annuity form, and “canceled” annuities would be “repurchased.”⁹⁹

3. *The 1977 Amendment*

Between 1968 and 1977, Sperry officials observed that similar funds managed by other investment managers, including a separate account managed for Sperry by Hancock, provided greater returns than GAC 50.¹⁰⁰ This prompted Sperry to seek to “remove funds from Hancock’s General Account and place them in other funds over which it could exercise more investment control”¹⁰¹ in a way that avoided charges under the contract’s Asset Liquidation Adjustment (“ALA”).¹⁰² The 1977 amendment sought to accomplish this in two ways. First, the LOF calculation performed upon an employee’s retirement no longer occurred automatically as it had from 1968 through 1977.¹⁰³ Rather, Sperry could choose to request that Hancock establish guaranteed benefits.¹⁰⁴ Sperry never made such a request.¹⁰⁵ Second, Sperry could use excess funds in the PAF (designated “free funds” during the course of the litigation)¹⁰⁶ to provide retirement benefits directly on a nonguaranteed basis.¹⁰⁷ The desire to use free funds for “pay-as-you-go” benefits and the concern for access or control over those free funds without triggering the ALA occurred because the PAF had grown much more than either Harris or Hancock had anticipated.¹⁰⁸

4. *Problems Arise (1977-83)*

The “use of free funds” issue following 1977 precipitated the lawsuit by

⁹⁹ See *Harris III*, 970 F.2d at 1141–42.

¹⁰⁰ *Harris II*, 767 F. Supp. at 1274.

¹⁰¹ *Id.*

¹⁰² See *id.* One analysis refers to this type of clause as a “surrender charge.” Goldberg & Altman, *supra* note 10, at 479. For the district court’s explanation of the calculation details regarding this charge or adjustment, see *Harris II*, 767 F. Supp. at 1279–80.

¹⁰³ *Id.*

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Harris IV*, 114 S. Ct. at 522.

¹⁰⁷ As the Supreme Court aptly explains: “These benefits were provided monthly on a pay-as-you-go basis; they were nonguaranteed in the sense that Hancock was obligated to make payments only out of free funds; i.e., only when the balance in the Pension Administration Fund exceeded the Minimum Operating Level.” *Id.*

¹⁰⁸ Justice Thomas notes: “The Pension Administration Fund, and thus the free funds, had grown beyond the parties’ expectations.” *Harris IV*, 114 S. Ct. at 537 (Thomas, J., dissenting).

Harris Trust (as trustee for the Sperry Plan) against John Hancock.¹⁰⁹ First, Sperry requested, and Hancock agreed, to transfer funds from GAC 50's PAF—without an ALA charge—to another GAC that needed contributions.¹¹⁰ Sperry also requested two additional “rollover” withdrawals of free funds.¹¹¹ After Hancock permitted such a transfer in 1979,¹¹² three things occurred: first, Hancock's coporate policy was amended in 1980 to deny rollovers except for grandfathered customers; second, Hancock allowed in 1981 a rollover for the year 1980; and third, Hancock eliminated rollovers entirely in 1981.¹¹³ This blocked Harris's access to free funds for “pay-as-you-go.”

In 1982, a second precipitating event occurred when Sperry requested Hancock to add a new division of Sperry employees to those already receiving “nonguaranteed” benefits from GAC 50's free funds.¹¹⁴ The parties disagreed as to the meaning of contractual language on point, whereupon Hancock exercised a contractual right and “gave [Sperry/Harris Trust] 31 days notice in writing that it would terminate all such [nonguaranteed or “free-funds”] payments.”¹¹⁵ Approximately one year later, Harris Trust, as trustee for the Retirement Plan, filed suit.¹¹⁶ Thus began the ten-year court battle of *Harris Trust*.

B. *The Lower Courts in Harris Trust*

Harris Trust alleged two types of claims: breach of fiduciary duty under ERISA and a variety of contractual and common-law claims.¹¹⁷ The trial court so divided the issues and granted Hancock's motions for summary judgment in both instances.¹¹⁸ Because *Harris II* deals only with the non-ERISA claims, its opinion is not analyzed in this Note.¹¹⁹

¹⁰⁹ See *supra* note 80.

¹¹⁰ *Harris II*, 767 F. Supp. at 1274.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.* at 1274–75.

¹¹⁴ See *id.* at 1276 (calling this a “significant event which preceded Hancock's alleged breach”).

¹¹⁵ *Id.*

¹¹⁶ *Harris III*, 970 F.2d at 1142.

¹¹⁷ *Harris I*, 722 F. Supp. at 999 (describing Harris Trust's suit as “alleging breaches of contract, breaches of fiduciary duty, professional malpractice, unjust enrichment and assorted violations” of ERISA).

¹¹⁸ See *id.* at 1020; *Harris II*, 767 F. Supp. at 1284.

¹¹⁹ “By its opinion . . ., this Court dismissed plaintiff's claim asserted under the Employee Retirement Income Security Act This motion relates to plaintiff's contract and common law claims.” *Harris II*, 767 F. Supp. at 1272.

1. Harris I: *Fiduciary Status Inapplicable to Hancock*

In *Harris I*, the district court ruled that Hancock was not a fiduciary under ERISA with respect to the part of Hancock's general account funds deemed "free funds"¹²⁰ because the court held that ERISA's guaranteed benefits policy exemption was applicable to GAC 50.¹²¹ That holding is the primary concern of the present discussion. However, two peripheral matters merit mention. First, the court rejected Hancock's argument that ERISA's "savings" clause¹²² and the McCarran-Ferguson Act¹²³ excluded Hancock from ERISA.¹²⁴ Under principles of "traditional preemption analysis,"¹²⁵ the court ruled in favor of dual federal-state regulation for insurers dealing in pensions.¹²⁶ Next, preclusion was held inapplicable to a prior district court ruling withdrawn and vacated pursuant to settlement.¹²⁷

The trial court then turned to the guaranteed benefits policy exemption issue.¹²⁸ The court announced a broad approach to its reading of the statute.¹²⁹ Interestingly, Justice Ginsburg later used the same quote in reaching a conclusion opposite that of the trial court.¹³⁰

Harris first argued that the contract constituted an investment contract, not an insurance contract.¹³¹ This argument is based largely on Judge Richard Posner's opinion in *Peoria Union Stock Yards Co. Retirement Plan v. Penn Mutual Life Insurance Co.*,¹³² wherein the Seventh Circuit addressed a contract similar to GAC 50.¹³³ Plaintiff's allegations included a breach of fiduciary duty

¹²⁰ See *Harris I*, 722 F. Supp. at 1020.

¹²¹ *Id.* at 1019.

¹²² 29 U.S.C. § 1144(b)(2)(A) (1988).

¹²³ 15 U.S.C. § 1011-1015 (1994). Broadly speaking, the McCarran-Ferguson Act prescribes the insurance industry to state regulation. For more on the McCarran-Ferguson Act, see KEETON & WIDISS, *INSURANCE LAW* 931-37 (1988).

¹²⁴ *Harris I*, 722 F. Supp. at 1006.

¹²⁵ *Id.* at 1003.

¹²⁶ "If the . . . state laws that govern Hancock's behavior relate to employee benefit plans and regulate the business of insurance, the laws would survive ERISA preemption. The state statutes and ERISA would *both apply* to the insurer's activities." *Id.* at 1004 (emphasis added) (footnote omitted).

¹²⁷ *Id.* at 1011.

¹²⁸ *Id.* at 1011-20.

¹²⁹ *Id.* at 1012 ("in expounding a statute, we [are] not . . . guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy") (quoting *Pilot Life Ins. Co. v. Dedaux*, 481 U.S. 41, 51 (1987)).

¹³⁰ See *Harris IV*, 114 S. Ct. at 523 (Ginsburg, J.).

¹³¹ *Harris I*, 722 F. Supp. at 1013.

¹³² 698 F.2d 320 (7th Cir. 1983) (Posner, J.).

¹³³ See *id.* at 322-23. The type of contract involved in *Peoria Union* was a "deposit

under ERISA, securities fraud under federal and state law, and related common-law claims¹³⁴ in connection with discrepancies between figures disclosed by the defendant/insurer and the insurer's internal summaries relating to the same account.¹³⁵ On appeal from a dismissal for failure to state a claim,¹³⁶ the Seventh Circuit considered whether the contract was an investment contract to which federal securities law would apply.¹³⁷ In dealing with the securities allegations, Judge Posner, relying on two Supreme Court securities cases dealing with variable annuities,¹³⁸ divided the contract into functional phases¹³⁹ and examined each phase for investment risk allocation.¹⁴⁰ Deciding that a claim was stated under securities law,¹⁴¹ Judge Posner turned to the ERISA claim and ERISA's guaranteed benefit policy exemption, noting that "Congress did not want to make an insurance company that sells a standard annuity contract—one that provides 'benefits the amount of which is guaranteed by the insurer'—a fiduciary toward the purchaser of the contract."¹⁴² He then immediately applied the identical investment contract analysis and came to the conclusion that the exemption did not apply to the contract.¹⁴³

administration contract," of which the IPG contract in *Harris Trust* is a type. See MCGILL & GRUBBS, *supra* note 15, at 562-64 (explaining that IPG's are offshoots of conventional DAC's and discussing differences).

¹³⁴ *Peoria Union*, 698 F.2d at 322. Judge Posner noted that the case was before him only on "the complaint and attached documents, which constitute the entire factual record in this case" *Id.* at 326.

¹³⁵ *See id.*

¹³⁶ *Id.*

¹³⁷ *Id.* at 324. Federal securities law defines "security" to include "investment contract." 15 U.S.C. §§ 77d(1), 78c(a)(10) (1994). For more on securities law and investment contracts, see LOSS & SELIGMAN, *supra* note 14, ch.3.A.1.d (1993).

¹³⁸ *See SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967); *SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65 (1959) (*VALIC*). For a discussion of these cases, see LOSS & SELIGMAN, *supra* note 14, ch.3.A.1.f (1993).

¹³⁹ *Peoria Union*, 698 F.2d at 325 (citing *United Benefit*, 387 U.S. at 207).

¹⁴⁰ *Id.* at 324-25 ("[W]e conclude that the concept of 'insurance' involves some investment risk-taking on the part of the company.") (citing *VALIC*, 359 U.S. at 71).

¹⁴¹ *Id.* at 326.

¹⁴² *Id.* at 327.

¹⁴³ The court's language following the prior quote reads as follows:

But that is not what Penn Mutual sold here. The pension trustees did not buy an insurance contract with a fixed payout; they turned over the assets of the pension plan to Penn Mutual to manage with full investment discretion, subject only to a modest income guaranty. If the pension plan had hired an investment advisor and given him authority to buy and sell securities at his discretion for the plan's account, the advisor would be a fiduciary within the meaning of the act, and that is essentially what the

Applying the *Peoria Union* framework to GAC 50, Judge Patterson rejected Harris Trust's argument on two grounds. On the one hand, the court generally questioned the applicability of the securities-based analysis to ERISA¹⁴⁴ and, more specifically, the Seventh Circuit's extension of *SEC v. United Benefit Life Ins. Co.*¹⁴⁵ to benefits contracts guaranteeing payment to the employee.¹⁴⁶ On the other hand, the court reasoned that even if *Peoria Union* did apply, Harris Trust's allegations of "illusory risk" to Hancock "misconstrued" the Supreme Court cases underlying *Peoria Union*, since those cases were concerned with "the transfer of risk from insured to insurer, not simply the nature of the risk the insurer might bear."¹⁴⁷ Looking at the underlying fact situation, the court found that Hancock did in fact bear actual risks.¹⁴⁸ The court also observed: "In sum, Harris Trust seems to be arguing that in hindsight, it does not like the bargain that it once struck. That argument should not change the terms of its contract, provided the covered employees are not prejudiced."¹⁴⁹ Additionally, the court noted that the terms "benefit" and "payment" in ERISA consistently refer to the actual payments to employees, not to employers.¹⁵⁰ Because GAC 50 did provide guaranteed fixed payments to employees, the exemption applied.¹⁵¹

In holding that Hancock's general account was not a plan asset, and that therefore Hancock was not a fiduciary,¹⁵² the court found support in both the

trustees did during the accumulation phase of the contract

Id. at 327. Compare Goldberg & Altman, *supra* note 15, at 488-90 (asserting that the bifurcation adopted in *Peoria Union* contravened both the language and policy of the guaranteed policy benefit exemption) with Rozmus, *supra* note 1, at 812-13 (discussing the case and conceding that the Seventh Circuit made only a "scant examination" of the exemption) and with *id.* at 825-27 (defending the *Peoria Union* result).

¹⁴⁴ *Harris I*, 722 F. Supp. at 1015 n.25 ("*Peoria's* holding as to the contract's exemption from the securities laws should not require the same result as to ERISA.>").

¹⁴⁵ 387 U.S. 202 (1967).

¹⁴⁶ *Harris I*, 722 F. Supp. at 1015-16.

¹⁴⁷ *Id.* at 1016.

¹⁴⁸ *Id.* at 1016-17 (including as actual risks of Hancock: (1) the guarantee of payments; (2) the possibility of reversion and repurchase and concomitant loss; and (3) miscalculation as to rates of interest and mortality).

¹⁴⁹ *Id.* at 1017.

¹⁵⁰ *Id.* at 1017-18. The court's use of "employer" may seem misplaced, but a close reading of the entire paragraph makes it clear that the the court used the term in that context, analogously to "contractholder." See *id.*

¹⁵¹ *Id.* at 1018.

¹⁵² The court concluded that

the sole passage in the legislative history that deals with the guaranteed benefit policy exception . . . confirms that while Congress did intend ERISA's fiduciary sections to

legislative history of ERISA,¹⁵³ and a Department of Labor Interpretive Bulletin (“IB 75-2”), later codified as a Department of Labor regulation.¹⁵⁴ The court did not give weight to two Department of Labor opinion letters contravening IB 75-2.¹⁵⁵ Harris Trust also argued that Hancock was a fiduciary as to the *contract itself*, not just to free funds.¹⁵⁶ The court noted that the contract itself was a plan asset but found that “only the contractholder, not the issuer,” was a fiduciary *as to that asset*.¹⁵⁷

This exposition of the district court’s first opinion laid the groundwork for the court of appeals and Supreme Court opinions, as the arguments therein remained essentially the same.

2. Harris III: *Reversal on the ERISA Issue by the Second Circuit*

As stated earlier in *Harris II*,¹⁵⁸ the district court also granted summary

cover variable annuity contracts, Congress did not intend to hold an insurer to a fiduciary standard if the contract it issues provides for fixed payments to the plan beneficiary.

Id. at 1017.

¹⁵³ The House Report (the “sole passage”) explains that “[i]f the policy guarantees basic payments but other payments may vary with, e.g., investment performance, then the variable part of the policy and the assets attributable thereto are not to be considered as guaranteed, and are to be considered as plan assets subject to the fiduciary rules.” JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE, H.R. REP. NO. 1280, 93d Cong., 2d Sess., *reprinted in* 1974 U.S.C.C.A.N. 5038, 5077, *quoted in Harris I*, 722 F. Supp. at 1017.

¹⁵⁴ The court cites, *inter alia*, to Department of Labor Interpretive Bulletin 75-2, later adopted as a regulation, dealing with prohibited transactions. The relevant section reads as follows:

(b) *Contracts or policies of insurance.* If an insurance company issues a contract or policy of insurance to a plan and places the consideration for such contract or policy in its general asset account, *the assets in such account shall not be considered to be plan assets.* Therefore, a subsequent transaction involving the general asset account between a party in interest and the insurance company will not, solely because the plan has been issued such a contract or policy of insurance, be a prohibited transaction.

ERISA Interpretative Bulletin, 29 C.F.R. § 2509.75-2 (1994) (emphasis added) (quoted in *Harris I*, 722 F. Supp. at 1018). This section was relied upon by both the Department of Labor and the insurance industry generally as a clarification of the guaranteed policy benefit exception. *See* Goldberg & Altman, *supra* note 10, at 484–86.

¹⁵⁵ *See id.* at 1018–19.

¹⁵⁶ *See id.* at 1019–20.

¹⁵⁷ *Id.* at 1019.

¹⁵⁸ *See supra* text accompanying note 118.

judgment to Hancock on the plaintiff's contractual and common-law claims.¹⁵⁹ Confronting an appeal of the ERISA claims of *Harris I*¹⁶⁰ and a contract claim from *Harris II*,¹⁶¹ the Second Circuit reversed in part. The court found fiduciary status as to the PAF's "free funds"¹⁶² but not as to the contract itself.¹⁶³ The court then affirmed both the nonpreclusive effect of a prior vacated judgment¹⁶⁴ and the district court's dismissal of the contract claim.¹⁶⁵

The court of appeals first focused on the "to the extent that" language of the exemption,¹⁶⁶ stating that "a contract is a guaranteed benefit policy *only* 'to the extent' that it provides for benefits that an insurer guarantees."¹⁶⁷ The court adopted the bifurcation analysis of *Peoria Union*¹⁶⁸ and decided that Hancock guaranteed only "one portion" of the contract's benefits, namely *not* the "free funds" portion, which the court described as "dependent upon the insurer's investment experience and therefore . . . variable with respect to the benefits it provides."¹⁶⁹ The court found support for that view in a different reading of the conference report relied upon by the district court¹⁷⁰ and in Judge Posner's characterization of the contract in *Peoria Union*, namely that the contract was like employing an investment advisor.¹⁷¹

Though noting the district court's observation that the term "benefits" in ERISA "refers to benefits and payments to covered employees" and not to the employer or the plan itself,¹⁷² the Second Circuit nevertheless viewed the lower court outcome as flawed¹⁷³ because "at certain times, until there is a conversion to guaranteed benefits, Hancock is managing assets taken in under

¹⁵⁹ *Harris II*, 767 F. Supp. at 1284.

¹⁶⁰ Technically the fiduciary duty breach had two parts: breach of fiduciary duty relating to free funds (the surplus in the PAF), and breach of fiduciary duty *as to the contract itself*. See *Harris III*, 970 F.2d at 1148.

¹⁶¹ *Harris III*, 970 F.2d at 1140. The claim essentially alleged that Hancock's termination of the "free fund" non-guaranteed benefit payments was a breach of contract.

¹⁶² See *id.* at 1142-45.

¹⁶³ See *id.* at 1145-46; see also *supra* note 143 and accompanying text.

¹⁶⁴ *Id.* at 1146; see *supra* notes 114-15 and accompanying text.

¹⁶⁵ *Id.* at 1146-48.

¹⁶⁶ For the relevant statutory language, see *supra* note 6.

¹⁶⁷ *Harris III*, 970 F.2d at 1143 (emphasis added).

¹⁶⁸ See *supra* notes 132-43 and accompanying text for a discussion of the *Peoria Union* case.

¹⁶⁹ *Harris III*, 970 F.2d at 1143.

¹⁷⁰ This same language is cited by the district court in reaching the opposite conclusion. See *supra* note 133.

¹⁷¹ *Harris III*, 970 F.2d at 1143.

¹⁷² *Harris I*, 722 F. Supp. at 1017-18; see *supra* note 150 and accompanying text.

¹⁷³ *Harris III*, 970 F.2d at 1144.

GAC 50 as to which there are no guarantees.”¹⁷⁴ The court of appeals made this statement in response to a quote from the district court’s opinion which spoke of Hancock’s guarantees and risks.¹⁷⁵ A close reading of these passages reveals an implied rejection of the district court’s reading of “benefits” as referring to those payments guaranteed by the insurer. The source of the concern seems to lie with the post-1977 use of PAF funds to provide “nonguaranteed”¹⁷⁶ benefits.

The court of appeals accepted the Department of Labor Advisory Opinions rejected by the district court, albeit ignoring the express limitations contained in those letters.¹⁷⁷ The court resolved the conflict between the letters and IB 75-2 by stating that the Interpretive Bulletin “was designed to deal with prohibited transactions in regard to conflict of interest situations. . . . There is no inconsistency in considering certain assets to be plan assets for general fiduciary duty purposes but not for prohibited transactions purposes.”¹⁷⁸ The court of appeals concluded that Hancock’s general account was not excluded under the guaranteed benefit policy language of ERISA.¹⁷⁹

III. THE SUPREME COURT DECISION

Hancock appealed on the “fiduciary as to free funds” issue, and the Supreme Court granted certiorari.¹⁸⁰ Ruling in favor of Harris Trust, the Court held that the free funds in GAC 50 were plan assets and, as such, subjected Hancock’s actions “in regard to their management and disposition” to ERISA’s fiduciary standards.¹⁸¹ Section A of this Part examines the majority opinion. Section B reviews the dissent of Justice Thomas.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*; see *supra* notes 148–49.

¹⁷⁶ The use of the term “nonguaranteed” proved unfortunate to Hancock. See *supra* note 151 and accompanying text.

¹⁷⁷ The district court rejected these private opinion letters because the letters were expressly limited to the parties and facts addressed by the letters, and because ERISA Procedure so limits the scope of the Advisory Opinions. See *Harris I*, 722 F. Supp. at 1019.

¹⁷⁸ *Harris III*, 970 F.2d at 1145. As will be discussed at greater length below, see *infra* notes 219–27 and accompanying text, this harmonization is strained. The prohibited transactions rules are fundamentally part and parcel of ERISA fiduciary law, and in fact are the main ways by which the general duties made concrete in the legislation.

¹⁷⁹ *Harris III*, 970 F.2d at 1145.

¹⁸⁰ 113 S. Ct. 1576 (1993).

¹⁸¹ *Harris IV*, 114 S. Ct. at 529.

A. *The Majority Opinion*

Writing for a 6-3 majority,¹⁸² Justice Ginsburg first stated a “wide-angle” standard of statutory review similar to that taken by the district court,¹⁸³ stating that the Court was “guided not by ‘a single sentence or member of a sentence, but look[ed] to the provisions of the whole law, and to its object and policy.’”¹⁸⁴ After reviewing basic ERISA definitions and the guaranteed benefit policy exemption, Justice Ginsburg characterized their meaning as “not mellifluous”¹⁸⁵ but “reasonably clear” when taken together.¹⁸⁶ In sum, she found the exemption to be “markedly confined” in comparison to other ERISA provisions,¹⁸⁷ focusing on the “words of limitation,” as did the court of appeals.¹⁸⁸ Ginsburg concluded: “Congress has specifically instructed, by the words of limitation it used, that we closely contain the guaranteed benefit policy exclusion.”¹⁸⁹

The Court next addressed the preemption argument,¹⁹⁰ affirming that a dual state-federal regulation scheme was proper, with ERISA trumping in the case of irreconcilable conflict.¹⁹¹ Turning to Hancock’s fiduciary status under ERISA as to general account funds, the Court decided to “follow the lead”¹⁹² of *Peoria Union* by examining the contract under securities law.¹⁹³ The *Peoria Union* framework first divides the contract into functional components (“accumulation” and “payout” phases),¹⁹⁴ then analyzes the components for

¹⁸² *Id.* at 517. Justice Thomas authored the dissent in which Justices O’Connor and Kennedy joined. *Id.* at 531.

¹⁸³ *Id.* at 523; see *Harris I*, 722 F. Supp. at 1012; see also *supra* note 129 and accompanying text.

¹⁸⁴ *Harris IV*, 114 S. Ct. at 523 (citations omitted).

¹⁸⁵ “Mellifluous” means flowing like honey. WEBSTER’S NEW WORLD DICTIONARY 268 (School and Office ed. 1971). This term is unique to Supreme Court jurisprudence. The author did locate, however, 15 uses of the term in other federal court opinions, as of February 12, 1995, referring (usually in the negative) to statutes.

¹⁸⁶ *Harris IV*, 114 S. Ct. at 524.

¹⁸⁷ *Id.* (“Notably, the guaranteed benefit policy exemption is not available to ‘any’ insurance contract that provides for guaranteed benefits but only ‘to the extent that’ the contract does so.”).

¹⁸⁸ See *supra* notes 166–67 and accompanying text.

¹⁸⁹ *Harris IV*, 114 S. Ct. at 525.

¹⁹⁰ See *supra* notes 122–26 and accompanying text.

¹⁹¹ *Id.* at 526.

¹⁹² *Id.* at 527.

¹⁹³ For a discussion of *Peoria Union*, see *supra* notes 132–43 and accompanying text.

¹⁹⁴ *Harris IV*, 114 S. Ct. at 527–28. This approach originated in *United Benefit*, 387 U.S. at 202 (holding that an annuity contract, for purposes of exemption from the Securities Act of 1933, could be deemed a nonexempt investment contract prior to the commencement

the investment risk allocation.¹⁹⁵ In deeming this analysis correct “because . . . the exemption applies only ‘to the extent that’ a policy or contract provides for ‘benefits *the amount of which is guaranteed*,”¹⁹⁶ the Court focused its attention on whether the *plan* received a fixed rate of return.¹⁹⁷ The Court reiterated this focus on the plan by describing the two situations with which it did *not* take issue. First, benefits “for which entries have actually been made in the Liabilities of the Fund” account, even during the accumulation phase, were within the exemption.¹⁹⁸ Second, if there was an end to the accumulation phase, i.e., if termination were triggered,¹⁹⁹ “all benefits thereafter payable under the contract” would also be covered by the exemption.²⁰⁰ In other words, the Court’s only concern was with free funds during the active or accumulation phase, and the extent to which Hancock guaranteed a rate of return *to the plan*.

In looking at the administration of free funds during the active phase, several factors drew the Court’s attention. First, the Court found it “undisputed” that to the extent of the 1977 amendment’s reference to “nonguaranteed” benefits,²⁰¹ “GAC 50 [did] not fall within the statutory exemption.”²⁰² Additionally, the Court saw features in GAC 50 which were reminiscent of the variable annuity in *United Benefit*, namely the “investment participation” feature of GAC 50 after 1968,²⁰³ and the determination that “until the occurrence of a triggering event . . . the investment risk is borne primarily by the contractholder.”²⁰⁴ These factors led the Court to decide, as did the Seventh Circuit in *Peoria Union*, that free funds during the accumulation were held by Hancock as an investment manager, not as an

of payout (the “accumulation” phase) and an exempt insurance contract after the start of payments (the “payout” phase)). *See supra* notes 138–40 and accompanying text.

¹⁹⁵ *Harris IV*, 114 S. Ct. at 527 (“[t]he concept of ‘insurance’ involves . . . risk-taking on the part of the company,” and “involves a guarantee that at least some fraction of the benefits will be payable in fixed amounts.”) (quoting *VALIC*, 359 U.S. at 71).

¹⁹⁶ *Harris IV*, 114 S. Ct. at 527.

¹⁹⁷ 29 U.S.C. § 1101(b)(2)(B) (1988 & Supp. 1993) (“The term ‘guaranteed benefit policy’ means an insurance policy or contract to the extent that such policy or contract provides for benefits the amount of which is guaranteed by the insurer. Such term includes any surplus in a separate account, but excludes any other portion of a separate account.”).

¹⁹⁸ *Harris IV*, 114 S. Ct. at 527–28.

¹⁹⁹ *See supra* notes 98–99 and accompanying text for more on termination.

²⁰⁰ *Harris IV*, 114 S. Ct. at 528.

²⁰¹ *Id.* *See supra* notes 95–96 and note 101 and accompanying text for the factual background relating to nonguaranteed benefits payable from the PAF and plaintiff’s displeasure upon defendant’s cancellation of those payments.

²⁰² *Harris IV*, 114 S. Ct. at 528.

²⁰³ *See supra* notes 86–95 for an explanation of the participation feature.

²⁰⁴ *Harris IV*, 114 S. Ct. at 528.

insurer.²⁰⁵ The Court even quoted *Peoria Union* to that effect.²⁰⁶ Thus, the Court concluded that the discretionary management of assets during a contract phase where no fixed rate of returns is provided and where no payments are guaranteed gives rise to ERISA fiduciary status.²⁰⁷

The Court next responded to Hancock's "provides for" argument.²⁰⁸ Hancock argued that the right of Harris Trust to purchase guaranteed benefits from free funds during any time meant that the contract provided for guaranteed benefits.²⁰⁹ Hancock made this argument in reliance on *Mack Boring & Parts v. Meeker Sharkey Moffitt*²¹⁰ which held that the "provide for" language of the exemption was satisfied if the funds provided for guaranteed benefits "at some finite point in the future."²¹¹ The Supreme Court rejected this reading, noting that the phrase "to the extent," as words of limitation, meant "only 'to the extent,'" as opposed to the word "if," which would signify a blanket exemption, and which would be how the Court would expect the statute to be drafted if Hancock's view were to prevail.²¹² Two features evidenced a lack of guarantee to the Court: (1) the PAF level was guaranteed only to its January 1, 1968 level; and (2) Hancock could set the price for converting free funds from the PAF to guaranteed benefits.²¹³

Hancock also argued that the free funds did not fall under ERISA's term "benefits" because ERISA defines benefits solely in terms of payments to participants.²¹⁴ The Court read this definition to mean *not* that the free funds fall outside the realm of plan assets, but rather that "[a] contract component that provides for something other than guaranteed payments to plan participants

²⁰⁵ *Id.*

²⁰⁶ *Id.* (quoting *Peoria Union*, 698 F.2d at 327). See *supra* note 143 for the quotation.

²⁰⁷ See *Harris IV*, 114 S. Ct. at 528 (quoting *Harris III*, 970 F.2d at 1144).

²⁰⁸ *Id.*

²⁰⁹ See Brief for Petitioner at 26, *Harris IV*, 114 S. Ct. 517.

²¹⁰ 930 F.2d 267, 273 (3d Cir. 1991).

²¹¹ *Harris IV*, 114 S. Ct. at 528 (quoting *Mack Boring*, 930 F.2d at 273).

²¹² *Id.* at 528-29 (emphasis added). The Court stated:

Congress did not say a contract is exempt "if" it provides for guaranteed benefits; it said a contract is exempt only "to the extent" it so provides. Using these words of limitation, Congress apparently recognized that contracts may provide to *some* extent for something other than guaranteed benefits, and expressly declared the exemption unavailable to that extent.

Id. The Court almost always writes "only 'to the extent'" when it speaks what it calls the "words of limitation." For more on this semantic construction, see *infra* notes 278-79 and accompanying text.

²¹³ *Harris IV*, 114 S. Ct. at 529.

²¹⁴ *Id.*; see also *Harris I*, 722 F. Supp. at 998, 1017-18 (citing various sections of Title 29 of the *United States Code*).

or beneficiaries—e.g., a guaranteed return to the plan—does not, without more, provide for guaranteed *benefits* and thus does not fall within the statutory exclusion.”²¹⁵ In other words, “guarantee” includes a *current* guaranteed rate of return on free funds and a guaranteed conversion price, because that lack of such guarantees “undeniably” exposes participants to the risk that “the future amount of benefits—payments to participants and beneficiaries—attributable to the free funds can fall to zero.”²¹⁶ The Court concluded that any contract “component” (phase) which does not allocate investment risk, defined as “a genuine guarantee of an aggregate amount of benefits” does not fall within the exemption, and that the indicators which are “key” with regard to free funds are (1) the guarantee of a reasonable rate of return, and (2) a conversion price set by the contract.²¹⁷ Since GAC 50 failed this test as to free funds, the free funds were deemed plan assets to which ERISA’s fiduciary rules attached.²¹⁸

Finally, the Court turned to Hancock’s reliance on the Department of Labor’s IB 75-2,²¹⁹ holding that the bulletin did not apply because it spoke only about prohibited transactions with parties in interest and not about the guaranteed benefit policy exemption itself.²²⁰ The Department of Labor’s attack on the Second Circuit’s distinction between “assets for general fiduciary purposes” versus “assets for prohibited transactions purposes” also failed because, again, IB 75-2 did not specifically deal with the issue.²²¹ IB 75-2 would have needed to address the “to the extent” language of the statute if it had meant to provide “an unqualified exclusion for an insurer’s general asset account.”²²² Further, the failure of the Department of Labor to provide an amicus brief to the Second Circuit²²³ was an indication to the Court that the Department of Labor had no “firm position” on the issue.²²⁴ Also, reliance on *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*²²⁵ was inapplicable because, in the majority’s view, the words “to the extent” were impermissibly interpreted to mean the broader “if” by the Department of

²¹⁵ *Harris IV*, 114 S. Ct. at 529.

²¹⁶ *Id.*

²¹⁷ *See id.*

²¹⁸ *Id.*

²¹⁹ *Id.* at 529–31. For more on this argument, see *supra* notes 154–55 and 177–79 and accompanying text.

²²⁰ *Harris IV*, 114 S. Ct. at 530.

²²¹ *Id.*

²²² *Id.*

²²³ *Id.*

²²⁴ *Id.* at 531.

²²⁵ 467 U.S. 837 (1984) (setting forth the circumstances under which a court will defer to executive branch agencies).

Labor.²²⁶ The Court also rejected the Department of Labor's concern for insurer disruptions, costs, and exposure to future litigation and referred the Department of Labor and Hancock to the "remedies" of statutory change or to "administrative relief [from the Department of Labor] . . . to facilitate insurers' compliance with the law" ²²⁷

B. Justice Thomas's Dissent

Justice Thomas's basic premise was that the majority's focus on the shift of investment risk was misplaced,²²⁸ and that the focus should instead have been on "whether, and to what extent" guaranteed benefits were provided.²²⁹ In considering the term "provide for," Thomas adopted the view that "a contract can 'provide for' guaranteed benefits before it actually guarantees future payouts—that is, before it shifts the investment risk as to those benefits to the insurer."²³⁰

Thomas preferred not to go beyond the "plain language" of the statute, assuming that "Congress 'says in a statute what it means and means in a statute what it says.'"²³¹ He disregarded the need to look to ERISA policy²³² or to "principles derived from the interpretation of dissimilar provisions" of securities law.²³³ In fact, Thomas viewed these sources as causing a "gloss" by the majority that overreached the clear language of the statute.²³⁴

In analyzing the statute, Thomas saw two basic requirements: (1) that the contract provide for guaranteed benefits,²³⁵ and (2) that the "amount" of the benefits be guaranteed.²³⁶ As to the "provide for" requirement, Justice Thomas felt that the meaning to be attached to this statutorily undefined term should be read according to its "ordinary speech" meaning.²³⁷ Under an ordinary speech view, the term means "make a provision for"—a notion concerned with the

²²⁶ *Harris IV*, 114 S. Ct. at 531.

²²⁷ *Id.*

²²⁸ *See id.* at 531–32 (Thomas, J., dissenting).

²²⁹ *Id.* at 532.

²³⁰ *Id.*

²³¹ *Id.* (quoting *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253–54 (1992)).

²³² *See id.* at 532, 534–35 (arguing against the majority's inclusion of broader ERISA policy, and asserting that Congress could have, but did not, mean to insulate plans from all risk, contrary to the majority view).

²³³ *Id.* at 532, 534 (arguing against the majority's use of a securities law analogy and noting that the issue in both securities cases—whether an annuity was insurance or investment—was not at issue in *Harris Trust*).

²³⁴ *Id.* at 534.

²³⁵ *Id.* at 532–33.

²³⁶ *Id.* at 533.

²³⁷ *Id.* at 532.

future rather than the immediate.²³⁸ In other words, a current contractual promise or plan for *future guaranteed benefits*, as opposed to a *current guarantee* of the amounts of future payments, meets the statute's "provide for" language.²³⁹ Paralleling the majority,²⁴⁰ Justice Thomas also provided a version of how the statute would have been drafted had Congress meant what the majority claimed, namely "to the extent that benefits, the amount of which is guaranteed by the insurer, *are vested in plan participants*."²⁴¹

As to the amount of benefits, the dissent argued that by looking at the returns to the plan as a whole, as opposed to payments to individual participants,²⁴² the majority placed a gloss on the statute that was "nowhere mentioned [by Congress] . . . despite the obvious superiority" of terms such as "allocation of risk, fixed payouts, or guaranteed investment returns."²⁴³ Maintaining its focus on guarantees to employees, the dissent noted that it is the plan, *not the policy*, which sets the amount of benefits to be received.²⁴⁴ The dissent further distinguished such a plan from one where "participants received either variable benefits or fixed benefit payments that were not guaranteed."²⁴⁵ If the policy guarantees its benefits, as does the first example, then "a variable return to the plan entails no such risk for plan participants."²⁴⁶ While agreeing with Ginsburg that "to the extent" does not mean "if," the dissent nonetheless contended that a focus on allocation of investment risk misstates the issue by looking beyond benefits guaranteed to employees to a guaranteed aggregate return.²⁴⁷

Though Thomas acknowledged the trust/fiduciary—insurance/contract dichotomy as well as insurers' industry-wide reliance on the Department of Labor's prior interpretation (albeit without addressing the majority's arguments as to the scope of IB 75-2),²⁴⁸ he did not give these factors "dispositive

²³⁸ *Id.* (citing *Rake v. Wade*, 113 S. Ct. 2187, 2192-93 (1993) (interpreting "provide" in a Bankruptcy Code section) and BLACK'S LAW DICTIONARY 1224 (6th ed. 1990) (defining "provide" as "to make, procure, or *furnish for future use*, prepare") (emphasis added)).

²³⁹ *Id.* (citing *Mack Boring & Parts Co. v. Meeker Sharkey Moffitt*, 930 F.2d 267, 273 (3d Cir. 1991)). "If 'provide for' is construed in this way, the insurance contract need not guarantee the benefits for any particular plan participant until the benefits have vested, so long as it makes provision for the payment of guaranteed benefits in the future." *Id.*

²⁴⁰ See *supra* text accompanying note 212.

²⁴¹ *Id.* at 533 (emphasis added).

²⁴² See *supra* notes 215-16 and accompanying text.

²⁴³ *Harris IV*, 114 S. Ct. at 533-34.

²⁴⁴ See *id.* at 535 n.4.

²⁴⁵ *Id.* at 534.

²⁴⁶ *Id.*

²⁴⁷ *Id.* at 535.

²⁴⁸ *Id.* at 535-36.

weight.”²⁴⁹ Rather, he counseled great caution, noting that the majority’s decision was far-reaching, because “[t]he free funds are not identifiable assets at all, but are simply an accounting entry in Hancock’s books. . . . To impose fiduciary duties with respect to the management of the free funds is essentially to impose fiduciary duties on the management of the entire line of [Hancock’s group pension] business.”²⁵⁰

Finally, looking directly at GAC 50, the dissent noted that the pre-1977 versions of the contract provided for no other means, besides termination, for the use of funds other than the purchase of guaranteed benefits.²⁵¹ In fact, Justice Thomas returned to the real world situation of the district court opinions.²⁵² Looking at changes in the market and the growth of free funds “beyond the parties’ expectations,”²⁵³ he noted that the original frustration of Harris Trust, which prompted the 1977 amendment, lay with the fact that

before the 1977 amendment the only . . . way [other than ‘termination’] the free funds could be used was to purchase guaranteed benefits for plan participants. It is difficult to see how a policy that provided for nothing but guaranteed benefits could be said not to provide for such benefits in its entirety.²⁵⁴

He also noted that the 1977 amendment “complicated” matters due to the payment of nonguaranteed funds. Justice Thomas therefore concluded that he would rather remand to find the effect of that change.²⁵⁵

IV. ANALYSIS

The Supreme Court’s decision presents several angles from which to launch an analysis. This Note focuses on two of its more curious aspects: (1) the use of securities law to analyze an insurance contract under federal pension benefits law; and (2) the dynamics of statutory construction that the Court develops in its analysis.

A. *The Application of Securities Law Analysis in Harris Trust*

The majority centered its argument on the “lead” it followed from *Peoria*

²⁴⁹ *Id.* at 536.

²⁵⁰ *Id.*

²⁵¹ *Id.* at 537.

²⁵² See *supra* part II.A (discussing the factual background of the parties).

²⁵³ *Harris IV*, 114 S. Ct. at 537.

²⁵⁴ *Id.*

²⁵⁵ *Id.*

Union.²⁵⁶ In doing so, the majority imported the *SEC v. Variable Annuity Life Ins. Co. of America*²⁵⁷ (*VALIC*) and *United Benefit*²⁵⁸ securities cases into the law of pension benefits,²⁵⁹ i.e., *VALIC*'s notion of "allocation of investment risk" and *United Benefit*'s bifurcation method.²⁶⁰ This Part contends that both ideas, while superficially appealing, are ill-suited to analyze this case.

In applying *VALIC* and *United Benefit*, the *Harris Trust* majority failed to grasp fundamental distinctions inherent in the bodies of law involved and the transactions at hand. First, both securities cases were injunctive actions by the Securities and Exchange Commission (SEC) to prohibit public offerings without undertaking registration under section 5 of the Securities Act of 1933.²⁶¹ Such an action varies greatly from an ERISA fiduciary action in terms of scope of liability and cure. SEC actions would merely require registration, whereas the retroactive imposition of fiduciary duty does not allow the comparatively simple cure of filing, but rather exposes eighteen years of dealings by an entire industry to huge potential liability. Additionally, these two areas of law have different origins and goals. Federal securities law, at least in the context of the cases cited,²⁶² arguably focuses only on disclosure.²⁶³ ERISA, as noted above,²⁶⁴ reaches much further than mere disclosure, primarily by importing trust law standards of conduct.²⁶⁵ To argue that the less stringent securities-law standards fit within ERISA's admittedly comprehensive scheme is to miss the whole point of an *exemption*. The application of too narrow a construction to an *exemption* from the fiduciary rules not only eviscerates Congress's express aim to make an exemption,²⁶⁶ but also thwarts a corollary legislative goal of ERISA, namely the *promotion* of

²⁵⁶ *Id.* at 527.

²⁵⁷ 359 U.S. 65 (1959).

²⁵⁸ *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1968).

²⁵⁹ *See supra* notes 138-43 and accompanying text for this discussion.

²⁶⁰ *Harris IV*, 114 S. Ct. at 527.

²⁶¹ *See VALIC*, 339 U.S. at 66; *United Benefit*, 387 U.S. at 204.

²⁶² *See supra* note 258.

²⁶³ Contrary to some state securities laws, federal securities law does not, at least theoretically, focus on substantive fairness, but only requires adequate disclosure. For a discussion of the history and background of the adoption of federal securities law relating to the "battle of the philosophies" of disclosure versus fairness, see LOSS & SELIGMAN, *supra* note 14, ch.1 § G.

²⁶⁴ *See supra* notes 71-77 and accompanying text.

²⁶⁵ *See supra* notes 61-70 and accompanying text.

²⁶⁶ In Justice Thomas's view, Congress intended neither to insulate plans from all risk, nor intended to subject all persons having any connection with contractual plan assets in the forms of insurance policies or securities issued by investment companies. *See Harris IV*, 114 S. Ct. at 534.

private pensions.²⁶⁷

Beyond the contrasting legislative goals of securities and pension law, the transactions in the securities cases supporting Posner's and Ginsburg's view vary greatly from GAC 50. In *VALIC*, a variable annuity case, the Court noted that one of two main features of the instrument was that "benefit payments"—money flowing to the parties meriting protection under the applicable law—varied with investment success.²⁶⁸ In economic terms, this "benefit payment" corresponds precisely to the benefit payments made to retirees under the policy, *not* to an investment interest component added to a fund *from which* guaranteed benefits were purchased, which was the intended use for PAF free funds according to the structure of the transaction. The majority in *Harris Trust* was able to link these different situations only by redefining "benefits" beyond the statute to include all returns *to the fund*, as opposed to payments flowing *to the beneficiaries*.²⁶⁹ The language of *VALIC*,²⁷⁰ so appealing to Ginsburg, cannot logically be read apart from the transaction upon which that language was based, namely one in which "[t]he holder of a variable annuity cannot look forward to a fixed monthly or yearly amount" ²⁷¹ That is the "investment risk" which concerned the Court in *VALIC*. Such a risk differs from the risk in GAC 50 in two respects. First, in GAC 50 there is no concern regarding actual payments to beneficiaries.²⁷² As the dissent noted, the PAF (the object of the majority's concern) grew. In fact, it grew more than Sperry and Harris Trust expected. Notwithstanding Harris's complaints as to its bargained-for costs,²⁷³ "to the extent" of the PAF growth the employer in *Harris IV* was that much more able to buy guaranteed benefits, which was, after all, the whole point of the contract.

In *United Benefit*, the investment vehicle at issue was one into which a contractholder deposited premiums to be invested up to some point of maturity. At that point, the contractholder either cashed out a dollar amount or purchased an annuity. The SEC sought to separate the agreement into two transactions or "phases," and to require securities registration as to the first phase.²⁷⁴ In other words, the SEC argued the nonapplication of the 1933 Act's section 3(a)(8)

²⁶⁷ "The purposes of this subchapter . . . are (1) to encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants" 29 U.S.C. § 1302(a)(1) (1988).

²⁶⁸ See *VALIC*, 359 U.S. at 69.

²⁶⁹ This is one of Justice Thomas's major concerns. See *Harris IV*, 114 S. Ct. at 535.

²⁷⁰ "[A]bsent some guarantee of fixed income, the variable annuity places all the investment risks on the annuitant, none on the company." *VALIC*, 359 U.S. at 71.

²⁷¹ *Id.* at 70.

²⁷² See *supra* notes 145–51.

²⁷³ See *Harris IV*, 114 S. Ct. at 537; *Harris I*, 722 F. Supp. at 1017.

²⁷⁴ *United Benefit*, 387 U.S. at 204.

“insurance contract” exemption to the pre-maturity arrangement. This *method* caught the eyes of the Seventh Circuit in *Peoria Union* and the Second Circuit in *Harris Trust*. Problems arise in the application of this division to GAC 50, however, because the application is by no means an apples-to-apples analogy. The *United Benefit* Court focused on two features: (1) before maturity, the contractholder could withdraw at any time (analogous to any investment); and (2) the investment “phase” was separable and independent from the annuity, such that it could be attached to any annuity/insurance product, or offered separately, and any insurance/annuity product could be offered without the investment component.²⁷⁵ Such factors are simply not present in GAC 50.

By the policy’s terms, Sperry did not have any withdrawal option apart from termination, which *any* contract would have to provide. The restrictions lacking in *United Benefit*—the very terms about which *Harris Trust* complained—were present here to avoid precisely the *United Benefit* situation. In fact, such restrictions add protection to employees in the long run by removing from the ready reach of plan managers a tempting source of money. Moreover, the PAF was never set up to be separable from the purchase of guaranteed benefits, unlike the so-called “Flex Fund” component found in *United Benefit*. If anything, the PAF’s structure dictates a total integration with the guaranteed benefit component.

In summary, it is argued that the *Harris Trust* majority rests on thin ground by applying both substantive and methodological structures to varying bodies of law which differ as to antecedent roots, goals, and remedies, especially where the legal “ground” relied upon bears no more than a remote resemblance to the transactions involved in the case before the Court.

B. *The Dynamics and Jurisprudence of Statutory Construction in Harris Trust*

A second problem with this case is the way the Court construed the statute at hand to reach its conclusion. This section is labeled “dynamics and jurisprudence” in an effort to highlight the dynamic of semantics present in the Court’s reasoning and to question the legal wisdom of that dynamic. The contention of the author is that the Court may have acceded to sophistic advocacy where its own wisdom ought to have remained inviolate, and that such a concession weakens the Court’s consistency, as well as public confidence in the Court.

The majority opinion in *Harris Trust* goes through a number of semantic flip-flops before concluding that free funds are plan assets. The Court initially claimed to adopt what may be termed a “wide” view of the statute’s meaning,

²⁷⁵ See *id.* at 205–07.

stating that it would be guided not by one mere sentence or member thereof, but also by wider concepts of overall legislative purpose.²⁷⁶ Not surprisingly, the dissent criticized this stance, preferring a model of statutory construction that focused on the statute itself.²⁷⁷

The majority, however, quickly abandoned its “wide approach” by focusing, in contradiction to its “not guided by one sentence” language, on the phrase “to the extent,” which it labeled “words of limitation.”²⁷⁸ Not surprisingly, the Court then reached the conclusion that an exemption to a general rule should be construed narrowly. Where did the wide approach go in this analysis? There is a semantic flip-flop, where one says “wide” but means “narrow.” As one continues down the road of the opinion, one might have expected that in the course of the “narrow view” analysis the Court would still adhere to its own wide approach understanding. Contradictory as it may sound, the Court could still have kept intact a “wide angle” view of the statute even when constrained to construe the provision narrowly. This would have at least preserved some content to its initial standard. But such hope is ill-placed, for the wide angle is effectively abandoned in favor of a jurisprudence of ever-narrowing, hyper-technical definitions. What *does* remain of the wide approach has already been discussed, namely the Court’s “following” the Seventh Circuit down the path of importing securities analysis into pension law. However, that wide angle approach initially announced by the Court is substantially abandoned in almost every other aspect of the Court’s analysis.

The Court narrowed its linchpin phrase “to the extent” to mean “*only* to the extent.” While the modifier “only” may seem to serve simply to highlight its referent “to the extent,” it in fact expresses far more. It expresses a misplaced, maternalistic desire on behalf of the Court “to insulate the plan from all risk,”²⁷⁹ which, though well-intentioned, is not found in the statute and belies the very existence of an exemption.

This hair-splitting approach of narrowing upon narrowing appears in other definitions, most notably in the Court’s rather amazing definition of “provide for.” As Justice Thomas notes, the majority reading of “provide for” ends up meaning something akin to a vesting of right to a benefit, instead of the usual meaning of “to make provision for.”²⁸⁰ This definition contravenes not only accepted legal definitions, but also appears to violate the Court’s very interpretation of that same phrase in a case decided less than a year prior to

²⁷⁶ See *Harris IV*, 114 S. Ct. at 523.

²⁷⁷ *Id.* at 533–34 (Thomas, J., dissenting).

²⁷⁸ *Id.* at 524–25.

²⁷⁹ See *id.* at 535 (Thomas, J., dissenting).

²⁸⁰ *Id.* at 532.

Harris Trust.²⁸¹ This is nothing less than definitional inconsistency and unfortunately could have the adverse effect of raising questions as to the consistency of the Court in general. The thought might run: *How can the Court construe the same generic term,*²⁸² *notwithstanding two different contexts, in two contradictory fashions within a twelve-month period of time?* Perhaps such definitional variance is acceptable or even appropriate since two different areas of law are involved. If that is the case, one might think the Court follows an “area-based” or “statute-based” approach to construction. Such an “area-of-the-law” approach, however, hardly fits an opinion which imports a whole body of analysis from another area of law.

This definitional inconsistency again surfaces in the Court’s view of “benefits.” Here, the meaning of the term seems clear, since “ERISA uniformly uses the word ‘benefits’ to refer exclusively to payments to plan participants or beneficiaries, not payments to plans.”²⁸³ The majority concedes as much, but then proceeds to turn this meaning on its logical head by connecting the statute’s “the amount of which” language with aggregate return to the plan, rather than with “benefits” payments to individuals.²⁸⁴ As the dissent explained:

Given that “benefits” refers to payments to individuals, “amount” standing alone most naturally refers to the amount owed to each individual. If, on the other hand, “amount” means aggregate amount, benefits to individuals could vary so long as the insurance company guaranteed that a fixed total amount would be paid.²⁸⁵

Another example of the Court’s curious use of terminology is its focus on the post-1977 “nonguaranteed” benefits feature of the contract. Both sides of the bench expressed concern over this term. The majority denied the application of the guaranteed benefit policy exemption. The dissent would remand on the issue. Interestingly enough, neither appears to have taken a look at the real-world working of this feature in relation to the case at hand.

As the lower courts noted, the 1977 amendments granted *Harris Trust* the right to use “credits” in the policy’s PAF to pay “nonguaranteed” benefits. This use may have contravened the exemption, yet the *primary* trustee of the plan, not *Hancock*, was the party who desired such an option and who

²⁸¹ *Rake v. Wade*, 113 S. Ct. 2187, 2192–93 (1993). See *supra* notes 237–38 and accompanying text.

²⁸² The verb is hardly a technical “term of art,” and the fact of nondefinition in either statutory scheme, both of which are fairly detailed, would tend to indicate so.

²⁸³ *Harris IV*, 114 S. Ct. at 529.

²⁸⁴ *Id.*

²⁸⁵ *Id.* at 533 (Thomas, J., dissenting).

exercised it happily. It was not Hancock who used the free funds for a purpose other than the purchase of guaranteed benefits; Harris Trust/Sperry did so. Furthermore, from 1977 it was the *plan*, not the insurer, who effectively stopped guaranteeing benefits, since under the 1977 arrangement Harris Trust needed only to ask Hancock to buy guaranteed benefits, but never did so. Nevertheless, when Hancock, perhaps seeing sizable depletions in the PAF by Harris Trust, put a stop to the depletions, Harris Trust turned around and sued for breach of fiduciary duty—and won. Therein lies the problem with *Harris Trust*.²⁸⁶ This point illustrates how what may be a significant part of the reality of a case is ignored in the perambulations of statutory construction.

In sum, the definitional flip-flops in *Harris Trust*, and its impractical importation of securities law, both tend to highlight a jurisprudence of sophistry where wide angle approaches turn into razor-fine distinctions, where definitions wander outside the realm of legal and even everyday usage, where definitions provided in recent cases are disregarded, and where the party who seeks to use up a pension policy's excess funds manages to convince the courts that the party who actually *stopped the siphoning* of funds should incur fiduciary liability for doing so. Such a jurisprudence hardly nurtures confidence in the Court.

V. ADMINISTRATIVE RESPONSE

The Department of Labor, whose interpretation was rejected by the Court and who was left with the option by the Court of providing “administrative

²⁸⁶ Consider the following hypothetical:

A and *B* contract for a “primary use” (purchase of guaranteed benefits). The funds connected with the contract (the PAF) grows. *A*, surprised to see the PAF growing, is disappointed because it cannot use the funds for non-primary uses. *B* then allows *A* to use funds from this “kitty” for what amounts to related but nonprimary uses (namely, nonguaranteed payments). *A* happily does so, but also ceases using the PAF for its primary use. *B* exercises its reserved right to cease this non-primary use, thus restoring the primary focus of the contract, the primary use. *A* sues *B* and claims, *inter alia*, that *B* was liable for letting *A* use funds for the non-primary purpose.

Should *A* be allowed to assert liability against *B* on the self-same theory that would, if *A* were sued by *A*'s beneficiaries, result in liability to *A*? Whose interests are being protected by the suit *A v. B*—the beneficiaries' or *A*'s? Moreover, which party, disregarding ulterior motives, showed greater care in the protection of the PAF (something akin to the garden discussed early on in this Note, the exemption notwithstanding): *A*, who was more than willing to use funds for nonprimary (and riskier because nonguaranteed) purpose, or *B*, who stopped such nonpayments (perhaps wanting to get back to primary purposes)?

If, in this example, *A* is Harris Trust, and *B* is Hancock, one sees more clearly the paradox of the case.

relief," issued, in July of 1995, a final regulation²⁸⁷ to ameliorate partly the effect of *Harris Trust*. The class exemption operates to exclude from the prohibited transactions rules "certain transactions engaged in by insurance company general accounts in which an employee benefit plan has an interest, if certain specified conditions are met"²⁸⁸ and for certain other similar types of situations not directly applicable to this Note. Ironically, the regulation cannot completely ameliorate *Harris Trust*, since the Department of Labor has authority to provide exemptions only as to the prohibited transactions rules, but not to general fiduciary duties.²⁸⁹ Moreover, the Department of Labor's discussion of the exemption does not do one thing that the Supreme Court in *Harris Trust* demanded, namely to squarely address the guaranteed benefit policy exemption. This lack of action seems to result from the nature of the Department of Labor regulation as affecting the prohibited transactions rules, as opposed to the guaranteed benefit policy exemption itself. In a sense, then, this regulation shares the same structure as IB 75-2, though it does speak directly to general account transactions. A comprehensive analysis of the regulation falls outside the scope of this Note, and may be the subject of future litigation, just as IB 75-2 came up in *Harris Trust*. In any event, *Harris Trust* lives, and will continue to entwine insurers in the thorny rosebush of ERISA.

²⁸⁷ Class Exemption for Certain Transactions Involving Insurance Company General Accounts, 60 Fed. Reg. 35925 (1995) (*hereinafter* "Class Exemption").

²⁸⁸ *Id.*

²⁸⁹ See 29 U.S.C. § 1108(a) (1988) (vesting power to grant exemptions to general fiduciary duties in the Secretary of the Treasury); Class Exemption, 60 Fed. Reg. at 35930.