Scrambled Nest Eggs

By Reg P. Wydeven
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When I graduated from law school in 1998 and joined our firm, I had to wait a year and a half before I could begin contributing to our 401(k) plan. My brother-in-law and frequent Post Crescent contributor, Michael Hochholzer, is a portfolio manager for Associated Wealth Management. He advised me that the best planning for retirement would be to contribute to my 401(k) early and often.

So in the summer of 1999, I began dumping as much in there as I could. Of course, this time frame inconveniently coincided with the stock market free fall, so like many investors I panicked and wished I had invested in comic books and baseball cards.

But as usual, Mike's advice rang true and my 401(k) has bounced back because I "bought low." Like me, many other investors' 401(k) plans took a hit when the market took a nosedive, but unlike me, some investors don't have another 30 years of employment for their plans to recover.

James LaRue lost $150,000 from his 401(k) when the market hiccupped, and he alleges it's his employer's fault. In 2000 and 2001, LaRue claims that he requested changes in his investment allocations in mutual funds that were available to participants in his company's 401(k) plan, however, those requests were not honored.

LaRue asserts he foresaw the downturn in stock prices, so he wanted more of his funds allocated to cash. When he discovered 10 months later that his instructions were not followed, that's when he realized he lost $150,000. In 2004, LaRue sued his employer after failing to reach a settlement, and his case is currently in front of the U.S. Supreme Court.

According to industry experts, by waiting three years to sue, LaRue hedged his bet. If, over those three years, the stock market went up, he made money, but if it dropped, he could always sue. To avoid this strategy, the American Council of Life Insurers advises that plan participants who claim their investment directions were not followed, such as LaRue, be denied the right to sue for damages in order to ensure they act promptly, seeking a court order if necessary.

LaRue's claims stem from the Employee Retirement Income Security Act (ERISA), which governs private-sector retirement plans in the U.S. There is estimated to be over $5.5 trillion in these plans, of which $2 trillion is in about 250,000 401(k) plans having 42 million employee-investors.

ERISA was passed in 1974 to protect retirement funds from misappropriation. Its passage came in the wake of some companies' failure to pay promised pensions and extensive skimming of corporate and labor union pension and welfare funds. Recent high profile ERISA cases involved class-action suits against Enron and WorldCom.

The other goal of ERISA was to encourage employers to establish retirement plans. As an added incentive, Congress limited participants' right to sue. Accordingly, the Supreme Court has sided with employers in past ERISA decisions.

The U.S. Chamber of Commerce is backing LaRue's employer, fearing a decision in his favor would open a floodgate of lawsuits by disgruntled investors. In addition, exposing plan administrators to broader liability would result in increased administrative costs for retirement plans, thereby decreasing the number of plans established or reducing the level of benefits.

I may still invest in a couple comic books just to be safe.