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## PENSIONS: SECURITY IN THE FUTURE OR SECURITIES UNDER THE LAW?

Private pension funds, an important source of capital for the development of commerce and industry, are extensively regulated under the Employee Retirement Income Security Act of 1974 (ERISA).<sup>1</sup> The Seventh Circuit, recognizing that these funds are also the sole investment vehicle for millions of Americans, ruled recently in *Daniel v. International Brotherhood of Teamsters*<sup>2</sup> that the antifraud provisions of the securities laws apply to pensions. In so ruling the court held that an interest in a pension fund is a "security"<sup>3</sup> and that participation in a pension plan involves a "sale"<sup>4</sup> of that security. The decision has aroused considerable interest because of its potential impact on the pension community and on those presently charged with implementing ERISA. This article introduces a new approach to pensions and the arguments raised in and by the *Daniel* decision.

### I. PENSIONS: GIFTS OR SECURITIES?

The first pension plan for employees of private industry in the United States was introduced in 1875 by the American Express Company. Similar plans were slow to be adopted and by 1930 only 2.8 million workers—fifteen percent of the privately employed, nonagricultural work force—were covered by pension plans.<sup>5</sup> During the 1930's, pension assets and reserves tripled (\$2.4 billion) and by the end of that decade the number of employees enjoying the benefit of private pension coverage had reached four million.<sup>6</sup> These pensions were generally considered to be a bounty or reward offered by benevolent employers to their employees. Therefore, although employees could expect something more than a gold watch at retirement, the right to receive any benefits was controlled solely by the employer.<sup>7</sup>

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1. 29 U.S.C. §§ 1001-1368 (Supp. V 1975).

2. 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 46 U.S.L.W. 3512 (U.S. Feb. 21, 1978) (No. 77-753).

3. *See* 15 U.S.C. §§ 77b(1), 78c(10) (1976).

4. *See id.* §§ 77b(3), 78c(14).

5. AMERICAN COUNCIL OF LIFE INSURANCE, PENSION FACTS 1976, at 19 (1976).

6. *Id.* at 9.

7. E. ALLEN, J. MELONE & J. ROSENBLUM, PENSION PLANNING 13-17 (3d ed. 1976).

Although the Federal Civil Service Retirement and Disability Fund was created in 1920,<sup>8</sup> Congress first dealt with private pensions when it enacted the Securities Act of 1933<sup>9</sup> and the Securities Exchange Act of 1934.<sup>10</sup> Prior to the enactment of this legislation, thousands of individuals had invested their life savings, accumulated after years of effort, in worthless securities. In summarizing the purposes of the legislation he sought, President Franklin Delano Roosevelt wrote the Congress on March 29, 1933: "What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others."<sup>11</sup>

The legislative history of these Acts indicates that Congress intended to include pension plans within the definition of a security. Securities and Exchange Commissioner Ganson Purcell, testifying before Congress in 1941, stated that among the proposals for amending the Securities Act which were advanced in 1934, one would have exempted from registration "an offering made solely to employees of an issuer or its affiliates in connection with a bona fide plan for the payment of extra compensation or stock investment plan for the exclusive benefit of such employees."<sup>12</sup> This proposal went to conference, but was eliminated by the conference committee, which felt that plan participants would need information concerning the issuer for whom they worked as much as members of the investing public need information about other issuers. As a result of this expression of Congressional intent, the Securities and Exchange Commission (SEC) had "no alternative but to interpret the [Securities] Act as applying to employees' pension plans which involve a 'sale.'"<sup>13</sup>

Therefore, as early as 1934, Congress and the SEC had accepted the premise that an interest in a pension fund is a security. However, the mere existence of a security, absent a sale, does not invoke the protections and requirements of the securities laws.<sup>14</sup> The SEC accepted the

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8. 5 U.S.C. §§ 8331-8348 (1976).

9. 15 U.S.C. §§ 77a-77bbbb (1976).

10. 15 U.S.C. §§ 78a-78hh-1 (1976).

11. H.R. REP. NO. 85, 73d Cong., 1st Sess. 2 (1933).

12. *Hearings on Proposed Amendments to Securities Act of 1933 and Securities Exchange Act of 1934 before the House Comm. on Interstate and Foreign Commerce*, 77th Cong., 1st Sess. 895-96 (1941) [hereinafter cited as *1941 Hearings*].

13. *Id.* at 896.

14. The 1933 Act requires registration only if there is a concomitant offer to sell or offer to buy. 15 U.S.C. § 77e(c) (1976). The antifraud provision of the 1933 Act, *id.* § 77q, is implemented only in the event of an "offer or sale" of a security. The antifraud provision of the 1934 Act, *id.* § 78j(b), requires that there be a "purchase or sale" before it is activated.

view prevailing at that time that a pension was a gratuity<sup>15</sup> if employees did not directly contribute money to the fund. If the pension was a gift from the employer to the employee, there was no disposition for value and, therefore, no sale under the Act.<sup>16</sup>

This position of the Commission was made public in an opinion letter from the Assistant General Counsel of the SEC, which stated unequivocally that an interest in an employee pension fund is considered an "investment contract," a term synonymous with "security." The letter went on to say, however, that the SEC required registration only when there was the presence of both a security and a sale. The Assistant General Counsel indicated that there was no sale for purposes of registration in the case of a noncontributory plan or a compulsory plan.<sup>17</sup> The absence of a sale was based on alternate theories. If the plan was noncontributory, there was no disposition for value, an express requirement under the Act. On the other hand, if the plan was compulsory, no voluntary investment decision was made by the employee.<sup>18</sup>

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15. PENSION PLANNING, *supra* note 7, at 14.

16. "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value." 15 U.S.C. § 77b(3) (1976).

17. *Id.* § 77b(1). [1975] 1 FED. SEC. L. REP. (CCH) ¶ 2105.53. This letter was an echo of Commissioner Purcell's testimony before Congress: "Any plan under which employees are given the opportunity to place part of their earnings in a fund which is to be invested for their benefit and returned to them at a later date involves the offering of an 'investment contract.'" 1941 Hearings, *supra* note 12, at 907, 908. Commissioner Purcell went on to explain the similarities between pension plans and investment companies offering securities to the general public. See generally, Jaretzki, *The Investment Company Act of 1940*, 26 WASH. U.L.Q. 303 (1941).

18. This second theory is not expressed in the securities laws. Congress did not amend the definition of "sale" to include an element of volition. The sudden need for this novel, but allegedly essential, ingredient of a sale may have had its beginnings in economic necessity. Many corporations hard hit by the Depression were attempting to reorganize, merge, somehow stay afloat on a very turbulent economic sea, when suddenly federal regulation came bursting over an already cloudy horizon. Perhaps the government had no desire to unnecessarily burden these battered corporations with the additional expenses of registration. Whatever the precise cause, the SEC did create a remedy to exempt mergers and similar corporate actions from the registration requirements of the 1933 Act. This corporate lifesaver—the "no sale" theory as it was called—made its public debut in 1935 as a note to Rule 5 of 1933 Act Registration Form E-1. The theory's rationale was later stated in the Brief for the SEC as Amicus Curiae, *National Supply Co. v. Leland Stanford Jr. Univ.*, 134 F.2d 689 (9th Cir. 1943).

In consolidations and mergers the alteration of the stockholder's security occurs not because he consents to an exchange, but because the corporation by authorized corporate action converts his security from one form to another . . .

Even though the stockholder may participate in the vote which results in changing his rights as a stockholder his action in so doing is the action of a member of the corporation exercising his franchise, rather than the action of a security holder choosing to accept an offer of exchange made to him as an individual.

The court stated that it was in accord with the "no sale" theory expressed in the SEC brief. 134 F.2d at 694. Then, in April 1947, the Commission rescinded Form E-1. Although

It is important to note that this letter found no sale for purposes of registration. The judiciary has long supported the view that a "sale" can exist within the meaning of the antifraud provisions of the 1933 and 1934 Securities Acts, despite the fact that the same transaction is not a "sale" for the purposes of registration.<sup>19</sup> Congress itself has cautioned that the same words may take on a different coloration in different sections of the securities laws, by prefacing the lists of general definitions in both Acts with the phrase "unless the context otherwise requires."<sup>20</sup>

In the same year that the opinion letter dealing with the pension interests was published, Congressman Paddock proposed a bill, H.R. 5065, which would have removed pension plans qualifying under what is now Section 401 of the Internal Revenue Code from the definition of "security."<sup>21</sup> The necessary implication arising from this bill is that if Congress had never intended that pension plans come within the securities laws, there would have been no reason to propose a bill to expressly exclude them. Further, assuming that pension plans had originally come under the Securities Acts, Congress could have removed the protections of those Acts by accepting Congressman Paddock's proposal.

The SEC opposed enactment of H.R. 5065. The Commission clearly indicated its position that pensions are securities and that the antifraud provisions are available to employees who have been denied their pensions:

H.R. 5065 could not only exempt employees' plans generally from the registration provision of the act, but it would also deprive employees of the protection now afforded them by the fraud provisions of the statute. Even if it be assumed that there are situations in which the protection of employees does not justify the expense of registration, it hardly follows that employees should be denied a right under the act to recover from employers who have actually deceived them. Under the act no securities at all, not even Government securities, are exempted from the fraud provisions of section 17(a).<sup>22</sup>

Upholding the position of the SEC, Congress defeated H.R. 5065.

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no mention of this theory was made in the rescission, it still continued as a Commission interpretation. Address by Manuel F. Cohen, Chief Counsel, Division of Corporation Finance, SEC, before the Association of the Bar of the City of New York, in New York City (Feb. 24, 1959).

19. SEC v. National Sec., 393 U.S. 453, 467 (1969); Cohen, *Rule 133 of the Securities and Exchange Commission*, 14 REC. A. B. CITY N. Y. 162 (1959); REPORT AND RECOMMENDATIONS TO THE SECURITIES AND EXCHANGE COMMISSION FROM THE DISCLOSURE STUDY ("The Wheat Report") 257-59 (1969).

20. SEC v. National Sec., 393 U.S. at 466.

21. 1941 *Hearings*, *supra* note 12, at 907, 919-20.

22. The Securities and Exchange Commission, Proposals for Amendments to the

## II. VALUE IS GIVEN FOR THE PENSION INTEREST

The 1940's were the source of two streams of development which would have profound effects on the "pension no sale" theory which the Commission thought it had established in bedrock. One development was the phenomenal expansion of pension plans in America;<sup>23</sup> the other, the judiciary's expansive interpretations of the terms "security" and "sale."

The period from 1940 to 1945 saw a dramatic growth in private pension plans, attributable to the establishment of the Social Security system, pressure from organized labor, social pressure, tax inducements, and wage stabilization. The War Labor Board introduced a program of wage stabilization as a part of a general price control scheme.<sup>24</sup> Employers could no longer compete for labor, which was scarce due to the war effort, by offering higher salaries. Unable to bargain for increased wages, union members challenged their leaders to justify unionism. In an attempt to offset these pressures on labor leaders and management, the War Labor Board permitted employers to create fringe benefit programs, including old-age and disability pensions.<sup>25</sup> In the competition to recruit new employees and to retain existing employees despite outside offers of alternate employment, the qualified retirement plan became an important component of the total compensatory package offered by employers and accepted by employees.<sup>26</sup>

Viewed against this background, pension plans can no longer be considered gifts from a beneficent employer. Sums paid and payable into the pension fund have been earned by each employee. The pension benefits are actually deferred compensation. Thus the term "noncontributory" is a misnomer, since the sum due each employee is expressly related to and

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Securities Act of 1933 and the Securities Exchange Act of 1934, 77th Cong., 1st Sess. at 15, 16 (Aug. 7, 1941).

Unfortunately this SEC position escaped the notice of all the parties involved in the *Daniel* case, including the SEC. In addition, the definition of sale for purposes of § 17(a) and, therefore, for Rule 10b-5, is not the same as for registration. Thus, even if the courts were to reject the *Daniel* theory of disposition for value, the unlitigated issue of whether there was a sale remains.

23. The number of active workers covered by private pension plans swelled by 6 million. Assets of these plans approached \$12 billion by the end of the decade. In the same year annual benefit payments totalled 961 million. PENSION FACTS, *supra* note 5, at 19, 21, 39.

24. D. MCGILL, FUNDAMENTALS OF PRIVATE PENSIONS 21-28 (1975); PENSION PLANNING, *supra* note 7, at 10.

25. As an added incentive to the establishment of private pension plans, employer contributions to plans meeting Internal Revenue Service requirements were made deductible, I.R.C. §§ 401-404.

26. See D. MCGILL, *supra* note 24, at 3-73 (1975).

measured by the employee's work.<sup>27</sup> Pensions have become a system of forced saving and investing, under which the American working public, convinced by employers and unions, foregoes present creature comforts and pleasures in exchange for security in old age.

The judiciary acknowledged these realities in *Inland Steel Co. v. NLRB*,<sup>28</sup> noting that employers were required to bargain on pensions and that such plans were part of the entire wage structure.<sup>29</sup> In reaching this decision, the court rejected the argument

that an employee is a stranger to a retirement and pension plan during all the days of his employment and that it affects him in no manner until he arrives at the retirement age. We think such reasoning is without logic. Suppose that a person seeking employment was offered a job by each of two companies equal in all respects except that one had a retirement and pension plan and that the other did not. We think it reasonable to assume an acceptance of the job with the company which had such plan. Of course, that might be described merely as the inducement which caused the job to be accepted, but on acceptance it would become, so we think, one of the 'conditions of employment.'<sup>30</sup>

The court thus recognized that a pension can have two characters, two personalities, depending upon the point in time at which the pension is viewed. First, as the court recognized, employee consideration of the offered pension involves a separate and distinct decision to be made in determining whether or not to accept employment.<sup>31</sup> Once accepted, the pension becomes a condition of employment that affects an employee's decision to keep a position.<sup>32</sup>

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27. See *Joint Indus. Board of Elec. Indus. v. United States*, 391 U.S. 224, 230, 231 (1968).

28. 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949).

29. *Id.* at 253. See 4 L. LOSS, *SECURITIES REGULATION* 2552 n.147a (2d ed. Supp. 1969).

30. 170 F.2d at 253.

31. *Id.* This view by the judiciary has been accepted by the Congress, which acknowledged the need to "give the employee-beneficiaries of these plans an accounting for the money they spend and which is spent in their behalf for future security benefits and permits them to appraise the merits of these plans, *which in many cases are held out to them as a competitive inducement of employment.*" S. REP. NO. 1440, 85th Cong., 2d Sess. 19 (1958), *reprinted in* [1958] U.S. CODE CONG. & AD. NEWS 4137, 4155 (emphasis added).

32. A pension program created by collective bargaining is not a gift which can be eliminated unilaterally by the employer, but rather reflects the employees' willingness to reduce demands in other economic areas. *International Ass'n of Machinists and Aerospace Workers, Lodge No. 1194 v. Garwood Indus., Inc.*, 368 F. Supp. 357 (N.D. Ohio 1973), *modified sub nom.* *International Ass'n of Machinists and Aerospace Workers, Lodge No. 1194 v. Sargent Indus.*, 522 F.2d 280 (6th Cir. 1975).

The *Inland Steel* case thus furnished a basis for including noncontributory and compulsory pension plans under the protection of the securities laws, because it established that an employee gives value in return for his interest in the pension plan, thereby meeting the Securities Act definition of sale. This approach to the pension fund interest as involving a sale of a security has emphasized the legislative history of the securities laws and the judicial history of pensions. However, the issue of whether an employee's interest in a pension fund involves a sale of a security was not presented to a court until *Daniel v. International Brotherhood of Teamsters* in 1976.<sup>33</sup> The *Daniel* court inverted the analysis. Instead of considering the legislative history of the securities laws and the judicial history of pensions, the court stressed the judicial history of the securities laws and the legislative history of pensions.

### III. DANIEL IN THE TEAMSTERS' DEN

John Daniel had worked as a truck driver for twenty-two and one-half years for employers who contributed to a pension fund jointly administered by the employers and the Teamsters.<sup>34</sup> Daniel applied for, but was denied, his pension by Local 705 because of his failure to satisfy the plan's length of service requirement. He had been laid off involuntarily for several months beginning in December 1960. This break in service interrupted the twenty consecutive years of employment necessary to be eligible for benefits under the pension plan. Daniel filed a class action in the District Court for the Northern District of Illinois against Local 705 and the International Brotherhood of Teamsters, charging that the pension denial violated the Securities Act of 1933, the Securities Exchange Act of 1934, the National Labor Relations Act, and common law principles of trust and fiduciary duties. He alleged that misleading statements of material facts and material omissions concerning length and continuity of service were violative of the federal securities laws. The Teamsters moved to dismiss the complaint, contending that the securities laws do not apply to an employee's interest in a pension plan, since pension plans are pervasively regulated under the Employee Retirement Income Security Act (ERISA).<sup>35</sup> The district court, in denying the motion to dismiss, held that an interest in a pension fund fits within the definition of a security; that the exchange of employee service for that interest in the fund is a sale within the meaning of the securities laws; and that the enactment of ERISA did not preempt the application of the antifraud

33. 410 F. Supp. 541 (N.D. Ill. 1976), *aff'd*, 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 46 U.S.L.W. 3512 (U.S. Feb. 21, 1978) (No. 77-753).

34. 561 F.2d at 1227.

35. 29 U.S.C. §§ 1001-1368 (Supp. V 1975).



provisions of the securities laws to interests in pension funds.<sup>36</sup> When the issue of whether the antifraud provisions of the securities laws apply to pension interests was certified on interlocutory appeal to the United States Court of Appeals for the Seventh Circuit, that court affirmed the district court's decision.<sup>37</sup>

In reaching its decision the circuit court relied on *SEC v. W.J. Howe Co.*,<sup>38</sup> in which the Supreme Court delineated the elements of an "investment contract" which would meet the statutory definition of a "security":

[A]n investment contract . . . means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.<sup>39</sup>

The *Daniel* court found that a pension plan contains the necessary elements of an investment contract: (1) money is invested in the plan by the employee when his employer makes a contribution; (2) the pension plan trustees are "third parties" who manage the plan; and (3) profits, in the form of retirement benefits, are expected from the successful management of the funds.<sup>40</sup>

The Teamsters argued that no profit element, and therefore no "investment contract" existed. In support of their position, the Teamsters relied heavily on *United Housing Foundation, Inc. v. Forman*,<sup>41</sup> in which the Supreme Court ruled that an interest in a cooperative housing development, although represented by a "stock certificate," did not constitute a security. The *Forman* Court noted that in light of the economic realities of the situation, the intent of the purchaser was to acquire housing, not to acquire a security.<sup>42</sup> In *Forman*, however, there was no risk to the buyer's initial investment<sup>43</sup> and the purchaser could not expect a profit from his purchase in the normal investment sense.<sup>44</sup>

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36. 410 F. Supp. at 547-53.

37. 561 F.2d 1223 (7th Cir. 1977).

38. 328 U.S. 293 (1946).

39. *Id.* at 298-99.

40. 561 F.2d at 1231-35.

41. 421 U.S. 837 (1975).

42. The *Forman* Court relied on *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967), which held that "in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality." *Id.* at 348.

43. See *SEC v. C. M. Joiner Leasing Corp.*, 320 U.S. 344, 348-49 (1943) (risk of loss of initial value is an essential attribute of a security).

44. The Teamsters argued that in view of *Forman*, a successful analogy cannot be

The Teamsters argued that a compulsory, noncontributory pension plan does not meet the *Forman* economic reality test, because the worker is merely making an employment decision, and not an investment decision.<sup>45</sup> Such an argument not only fails to comport with the analysis of the court in *Inland Steel*,<sup>46</sup> but also harkens back to the days when pensions were considered gifts. The economic inducement of the pension alters the basic nature of the employment decision, and this alteration is critical to any application of the *Forman* economic reality test to an interest in a pension plan.<sup>47</sup>

In addition, the *Howey* Court had held that an interest in a citrus grove development was an "investment contract" because that interest fell within the language of section 2(1) of the Securities Act of 1933 which defines a "security" as any "investment contract." In so holding, the *Howey* Court had rejected the argument that the existence of an investment contract is precluded "where the tangible interest which is sold has intrinsic value independent of the success of the enterprise as a whole."<sup>48</sup> Just as the Supreme court recognized in *Howey* that there was more than a purchase of citrus groves, the *Daniel* court found that the employees were not just accepting jobs, but were investing their right to present compensation in the hope of securing a deferred income from the competent administration of the pension fund by independent third parties.

The Teamsters argued that there was no expectation of profit by an employee in a compulsory, noncontributory pension plan and that under

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drawn between an interest in a pension and a security. The fallacy in this argument is apparent when considered in light of the following statement of former Chairman of the SEC, Manuel F. Cohen: "Interests in a private pension plan fall within the definition of a security under the Securities Act of 1933, and most private pension plans would be subject to regulation under the Investment Company Act of 1940 but for a specific exemption from that statute." *Hearings on S.3598 before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare*, 92d Cong., 2d Sess. 231 (1972). See generally, Mundheim & Henderson, *Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans*, 29 LAW AND CONTEMP. PROB. 795 (1964). Since the SEC never changed its position that interests in private pensions are securities, one is left to wonder why it is necessary for the Teamsters to create an analogy.

45. See Brief for Appellant at 18-21, and Brief for the Secretary of Labor as Amicus Curiae at 5-8, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977).

46. 170 F.2d 247 (7th Cir. 1948), cert. denied, 336 U.S. 960 (1949). See text accompanying notes 28-30 *supra*.

47. The *Forman* Court recognized the need to consider the whole transaction: "'Undisputed facts seem to us, however, to establish the conclusion that defendants were not, as a practical matter, offering naked leasehold rights. Had the offer mailed by defendants omitted the economic inducements of the proposed and promised exploration well, it would have been quite a different proposition.'" 421 U.S. at 853 n.18 (quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 348 (1943).

48. 328 U.S. at 298, 301.

the *Howey* decision a security must involve an expectation of profit.<sup>49</sup> Since the benefit is defined,<sup>50</sup> there is no profit. This argument is faulty for several reasons. The term "profit" as used in the *Howey* formula was a description of an investment yield. The *Howey* Court had expressly rejected the suggestion that there could be no security unless an enterprise was speculative, i.e., the degree of risk was sufficiently high so as to make the investment speculative.<sup>51</sup> However, the existence of a security has been found when financial gain does not vary from year to year, but the risk of loss varies with the promoter's management skills.<sup>52</sup> The distinction is precisely the same as that between a common stock and a corporate bond. Typical debt securities carry an obligation to pay a fixed return, yet no one denies that corporate bonds or debentures are encompassed by the securities laws, even though they fail the *Forman* test as construed by the Teamsters.<sup>53</sup>

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49. The need to find a "profit" element comes from the express language used in *Howey*. However, the genesis of the *Howey* formula preceded the *Howey* decision. The *Howey* Court admittedly was accepting "in other words" the language used in *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 56, 177 N.W. 937, 938 (1920), in which the state supreme court held that an investment contract "came to mean a contract or scheme . . . intended to secure *income or profit*." 328 U.S. at 298 (emphasis added). Considering the deference the *Howey* Court gave to the meaning "crystallized by this prior [state] judicial interpretation," *id.*, there seems to be no valid reason to reject the language of the original formula enunciated by the high court of Minnesota. Under this formula the final element necessary to the existence of an investment contract is either income or profit. A defined benefit is recognized as income and, therefore, satisfies the original investment contract formula.

Congress, recognizing pensions as income, stated: "Regardless of the form they take, the employers' share of the cost of these plans or the benefits the employers provide are a form of compensation." S. REP. NO. 1440, 85th Cong. 2d Sess. 4 (1958), *reprinted in* [1958] U.S. CODE CONG. & AD. NEWS 4137, 4139.

50. Defined benefit plans provide a fixed benefit from the employer. The benefits are established by a formula and contributions are based on actuarial calculations of the amount necessary to fund those benefits. The contributions will vary according to fund earnings and benefit payments. In contrast, under a defined contribution plan, the contributions rather than the benefits are defined by a formula. The benefits payable at retirement are based on the amount of money that has been set aside for each employee during his working years and the earnings accrued as a result of the investment of that money.

51. 328 U.S. at 301.

52. *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974). Consequently, the profit element can be satisfied by a regular fixed return on an investment, as in a defined benefit plan. *See SEC v. Variable Annuity Life Ins. Co. of America*, 359 U.S. 65, 67-68 (1959) (the term "security" is broad enough to include any annuity contract, not just variable annuities). *Cf. Silver Hills Country Club v. Sobieski*, 55 Cal.2d 811, 361 P.2d 906, 13 Cal. Rptr. 186 (1961) (the objective of the corporate securities act was to afford those who risked their capital at least a fair chance of realizing their objectives in legitimate ventures whether or not they expect a return on their capital in one form or another).

53. Like an interest in a pension fund, debt securities carry no voting rights. They are

Nevertheless, subsequent to the district court decision in *Daniel*, but prior to the affirmance by the circuit court, the Teamsters successfully argued that a participant in a defined benefit plan cannot have an expectation of a profit. In *Wiens v. International Brotherhood of Teamsters*,<sup>54</sup> the United States District Court for the Central District of California held that an employee's interest in a noncontributory pension is not a security, and that even if it were a security, there is no sale of that security.<sup>55</sup> The court also failed completely to recognize the risk of the initial investment.<sup>56</sup> Since the employee under a defined benefit plan receives his pension according to an established schedule, whether or not the enterprise has suffered losses,<sup>57</sup> the court found that the employee does not agree to bear the losses of the enterprise. Nonetheless there is a risk. A defined benefit plan must be actuarially sound so that the monies to pay the defined benefits will be available when needed. As in many investment situations, the pension participant lacks familiarity with and control over the enterprise, and thus is in great need of the antifraud protections offered by the securities laws.<sup>58</sup> The employee, like the *Wiens* court, may ignore the element of risk, only to discover its existence after investing years of labor.

The Teamsters' local not only recognized the existence of the employees' expectation of profits, but it also catered to that profit motive by making the fund more appealing to both current and would-be participants.

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issued with a stated maturity date, analogous to a pension plan's fixed retirement date. They are typically redeemable at the option of the corporation, usually when the interest rate on the bonds is found to be excessive in light of interest rates in the marketplace. Similarly, pension plans may be terminated for a valid business reason. Debt securities, like interests in a pension fund, are typically issued pursuant to an elaborate contract or indenture between the corporation and a trustee for the benefit of the holders of the securities.

54. [Current Volume] FED. SEC. L. REP. (CCH) ¶ 96,005 (C.D. Cal. Mar. 28, 1977).

55. In an unpublished opinion, the court stated that an employee does not sell his labor in order to purchase an interest in the pension plan. *Id.* at 91,519. The court ignored arguments concerning the SEC position on the issue, noting erroneously that this "position has suddenly shifted after a long period in the other direction." *Id.*

56. *Contra*, SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943).

57. *But cf.* Nachman Corp. v. Pension Benefit Guar. Corp., 436 F. Supp. 1334 (N.D. Ill. 1977) (the right to future payments has no present value except in terms of the future success of the enterprise).

58. The theory that there is no risk in a defined benefit plan stems from the fact that the benefit is both ascertainable under the terms of the plan and guaranteed by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). 29 U.S.C. §§ 1301-1381 (Supp. V 1975). The PBGC, however, offers only a limited guarantee of vested benefits. Therefore, if an employer becomes insolvent and terminates his pension plan, the employee stands to lose any part of the defined benefit not insured by the PBGC, even though the employee has already given full value in the form of services rendered. However, the

Although there are many factors which go into the actuarial calculation, one of the most important is the investment performance of the fund . . . . As Local 705 explained to its members in 1969 in one of its information booklets: 'Another advantage [of the Local 705 plan] is that the contributions earn income by being invested. Consequently, the money originally contributed grows. Without this income growth, the fund could not accumulate enough money to pay the \$250.00 monthly pensions provided by the Plan.'<sup>59</sup>

#### IV. THE "PENSION NO SALE" THEORY

The original objection to applying the securities laws to compulsory, noncontributory plans stemmed from the SEC's belief that the employee neither gave value<sup>60</sup> nor made an investment decision in such plans.<sup>61</sup> The district court in *Daniel*, however, held that there is a sale, because "economically there is no distinction between the facts here [i.e., compulsory employer contributions] and the situation whereby the employee first receives as part of his wages the employer contribution in

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better the investment experience of the pension fund, the greater a likelihood that an employee will receive the entire expected return on his investment, if he has also maintained his status as an eligible plan participant. This investment risk consists of several factors: whether the fund's investment experience meets its projected rate of return; whether the employee achieves and maintains his eligibility; whether the money in the fund is properly managed; and whether the plan will last long enough for the employee to become vested. See *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202 (1967). In *United Benefit*, the Supreme Court reversed the lower court holding that the guarantee of a fixed payment annuity of a substantial amount gave the entire contract the character of insurance. The Court accepted the SEC argument that the contract should be fragmented, since two entirely distinct promises were included in the contract, and their operation was separated at a fixed point in time. In the pension situation, the PBGC guarantee of a portion of a defined benefit, while reducing substantially the investment risk, does not make the risk disappear. The risk of insufficiency of the pension fund to pay the defined benefit was believed to be shared by the employer and the employee. However, if recent court decisions indicate any judicial trend, it is toward a very limited definition of employer liability. See *Nachman Corp. v. Pension Benefit Guar. Corp.*, 436 F. Supp. 1334 (N.D. Ill. 1977); *Pension Benefit Guar. Corp. v. Tenn-Ero Corp. and Avon Sole Co.*, Bankruptcy Nos. 75-1520-HL & 75-1521-HL (D. Mass. May 13, 1977), 13 C.B.C. 187; *Pension Benefit Guar. Corp. v. Ouimet Corp.*, Civ. No. 76-1314-T (D. Mass. May 13, 1977).

59. Brief for the SEC as Amicus Curiae at 11, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977).

60. "The term 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security *for value*." 15 U.S.C. § 77b(3) (1970) (emphasis added).

61. It is clear that § 2(3) of the 1933 Act does not purport to set forth an all inclusive expression of the meaning of "sale". That section is couched in terms of "shall include," as contrasted with the use of the word "means" in 12 of the remaining 13 terms referred to in § 2. The word "means" may encompass the universal meaning of a word, but "includes" clearly indicates that there are other meanings. Indeed, the introductory words of

cash and then pays such cash over to the pension fund."<sup>62</sup> Although the Teamsters challenged this position on appeal, their objection was formalistic at best, since they had admitted in their brief that "non-contributory pension plans . . . constitute a form of compensation for an employee's labor."<sup>63</sup> Moreover, the money that the employer contributes to the pension program is "limited to money that he might otherwise spend for wages or other employee benefits."<sup>64</sup> Thus the employee exchanges his labor for the interest in the pension plan. The giving of labor in exchange for a security has been held to constitute disposition for value.<sup>65</sup>

In *Daniel*, the appellate court found that the employees made an investment decision when they voted on the union-negotiated package, which set out the division of income between salary and pension benefits.<sup>66</sup> The "pension no sale" theory assumes that the exchange of services for an interest in the pension fund occurs not because the participant consents to it, but because through authorized collective bargaining the union and employer create the employee's interest. The court recognized that at best this is correct only in a technical sense since it overlooks the substance of the transaction. Even though a ratification vote is not required by law,<sup>67</sup> the constitution of the International Brotherhood of Teamsters requires ratification of all collectively bargained decisions. In voting, each member is expressing his voluntary and individual acceptance of the interest in the pension fund. The union acceptance is, therefore, the aggregate effect of the will of each participant to accept or reject the terms of the exchange. Only the participant

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§ 2 state that the meanings expressed for the statutory terms are set forth "unless the context otherwise requires," indicating that someone must interpret these words further in appropriate instances. Since the SEC was set up to administer the Act, it would appear that the Commission is the entity to perform this function. Certainly it is the best qualified. On this basis, the Commission has the power to adopt a rule interpreting the term "sale".

62. 410 F. Supp. at 553.

63. Brief for Appellant at 11, 12, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977).

64. [1958] U.S. CODE CONG. & AD. NEWS 4137, 4144.

65. See *Collins v. Rukin*, 342 F. Supp. 1282 (D. Mass. 1972), in which the court agreed with this line of reasoning.

66. 561 F.2d at 1243-44. The Department of Labor, *inter alios*, has challenged this decision as a denial of the exclusive representation principle so fundamental to labor law and policy. Brief for Secretary of Labor as Amicus Curiae at 5-14, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977). The union's exclusive right to speak for represented employees has received judicial sanction as a first principle in labor relations. *Medo Photo Supply Corp. v. NLRB*, 321 U.S. 678 (1944); *NLRB v. National Motor Bearing Co.*, 105 F.2d 652 (9th Cir. 1939). In spite of this exclusive right, members' views are often registered prior to negotiations through information meetings and polls.

67. *Cleveland Orchestra Comm. v. Cleveland Fed. of Musicians, Local No. 4*, 303 F.2d 229, 232-33 (6th Cir. 1962).

who voluntarily accepts the exchange remains bound thereby, since each employee makes a decision to continue working under the new contract. It seems anomalous to compress the entire decision-making process and give recognition to only a portion of what transpires, while ignoring the ratification process necessary under the union constitution.

Finally, if the *Daniel* case had involved a voluntary, contributory plan, there would have been nothing novel in a finding by the court that an employee's interest in such a plan involved a sale of a security. The SEC has long maintained that very position without challenge.<sup>68</sup> Although the issue was not raised before the court, the pension in *Daniel* can be considered voluntary and contributory, because it changes its fundamental nature depending on the employment status of the worker/participant. The plan provides that whenever the employer is not obligated to make contributions (e.g., if the employee is laid off), the employee may elect to make such contributions and thereby remain a participant in the plan.<sup>69</sup> Thus, during his involuntary break in service, Daniel could have elected to be a voluntary, contributing member to the plan which at that point was no longer compulsory and noncontributory. Under such circumstances his participation would have unquestionably involved disposition for value. Consequently, by its own terms, the double aspect of the plan placed it within the reach of the securities laws.<sup>70</sup>

#### V. APPLICATION OF THE SECURITIES LAWS TO PENSIONS: CONGRESSIONAL INTENTION OR ADMINISTRATIVE INTRUSION?

The *Daniel* court held that public policy dictated the application of the antifraud provisions of the securities laws to provide protection not

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68. [1977] 1 FED. SEC. L. REP. (CCH) ¶ 2105.50. In addition, since the major justification of the "no sale" rule rests on the premise that the participant is not exercising any individual choice, proof that a volitional element exists should negate the rule. Consequently, situations in which possible elements of individual choice arise deserve careful scrutiny.

69. Such contributions by the employee may be made for up to three months, after which the employee must petition for an extension if necessary. See Brief for the SEC as Amicus Curiae at 12, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977).

70. To the extent that John Daniel was not affirmatively made aware of his right to maintain his eligibility in the plan and was not informed that the failure to exercise that right might involve a loss (as it did), there existed a material omission by the administrators of the plan. Such an omission is in violation of the antifraud provisions of the securities laws, which have always been held to apply to voluntary and contributory pension plans. [1977] 1 FED. SEC. L. REP. (CCH) ¶ 2105.50. Therefore, the break in service, which the defendants argue should deny the plaintiff his right to a pension, in reality reinforces the right to apply the securities laws and their protections to this pension plan.

available either through qualification under the Internal Revenue Code<sup>71</sup> or through existing pension legislation.<sup>72</sup> This finding that a nexus exists between securities and pensions sufficient to warrant the application of the securities laws has aroused a storm of objections.

When Congress enacted ERISA, an intricate administrative system<sup>73</sup> was established to implement the new pension policy. Since this legislative plan is so detailed and extensive, the defendants argued that any judicial imposition of additional duties would conflict with Congressional intent.<sup>74</sup> However, ERISA itself provides that: "[n]othing in this [title] shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States . . . or any rule or regulation issued under such law."<sup>75</sup> Significantly, although ERISA generally exempts pension plans from state pension laws,<sup>76</sup> the Act specifically states that it is not to be construed to exempt pension plans from state laws regulating securities.<sup>77</sup> It would seem farfetched to claim that although no federal laws have been preempted by ERISA<sup>78</sup> and no state laws dealing with securities have been superseded by ERISA, Congress, nonetheless, implied a suspension of the federal securities laws. Such an argument not

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71. I.R.C. § 401.

72. See 29 U.S.C. §§ 1001-1381 (Supp. V 1975).

73. *Id.* §§ 1301-81.

74. Subsequent to *Daniel*, the Teamsters successfully argued this point in *Hurn v. Retirement Fund Trust of the Plumbing, Heating & Piping Indus.*, 424 F. Supp. 80 (C.D. Cal. 1976). In addition to holding that a participant's interest in an employee pension plan is not a security and that the acquisition of that interest does not involve a sale, the court held that ERISA "provides the exclusive remedy for disputes over benefits between 'participants' . . . and 'employee pension benefit plans.'" *Id.* at 82. *Cf. El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224 (9th Cir. 1974). Appellants in *El Khadem* had argued that the elements which the court relied upon to find the existence of a security are present in a wide variety of financial transactions. However, the court noted that these transactions are explicitly exempted from registration under 15 U.S.C. § 77c (1976). The exemption was "not because investors do not need protection, but because other agencies regulate the institutions involved." 494 F.2d at 1230 n.14. The very same arguments may be raised regarding the 1970 amendments to the securities laws and pension fund interests. ERISA provides a certain protection, analogous to the registration requirements of the Securities Act. Compare 29 U.S.C. §§ 1021-1031 (Supp. V 1975) with 15 U.S.C. § 77g (1976). However, nowhere in ERISA is there the broad protection offered by the antifraud provisions of the securities laws. ERISA provides no relief for fraud perpetrated outside of those limited written materials required under the Act. 29 U.S.C. § 1132 (Supp. V 1975). Multiple risks to employee pension interests are like the heads of the Hydra of Greek mythology. Eliminating one head may look quite impressive, but it does not kill the monster.

75. 29 U.S.C. § 1144(d) (Supp. V 1975).

76. *Id.* §§ 1003(a), 1144(b)(2)(A).

77. Also left untouched are state laws dealing with banking and insurance. *Id.* § 1144(b)(2)(A).

78. But see 29 U.S.C. § 1031 (Supp. V 1975) (repealing the Welfare and Pension Plans Disclosure Act, Pub. L. 85-836, 72 Stat. 997 (1958)).



only inverts a *fortiori* logic, but it also ignores the rules of statutory construction.<sup>79</sup>

In enacting ERISA, Congress sought to protect employees and their dependents when pension funds terminate without sufficient assets to satisfy the benefit expectations of its participants. ERISA is an attempt to minimize losses to beneficiaries by reducing the probability of self-dealing on the part of fund trustees, bad investments by fund administrators, and inadequate funding. This legislation deals with the ongoing administration of pension funds, not the decision to participate in the pension plan. ERISA was created to protect an employee's interest in his pension plan,<sup>80</sup> rather than to prevent fraud in the acquisition of that interest. This intent is clear from the timing of ERISA disclosures to plan participants, since disclosures are only required after an employee has entered the plan.<sup>81</sup>

In contrast, under the securities laws disclosure must be made at the time of the offer<sup>82</sup> to provide the investor with an opportunity to make an informed decision. A similar disclosure would give the potential plan participant the opportunity to make an informed decision whether to accept or reject an interest in the pension fund.<sup>83</sup> If employees are made aware of the risks that exist in their pension plans, they can more realistically consider the problems of providing for themselves and their families after retirement. For example, a plan may be terminated with impunity for a valid business purpose.<sup>84</sup> In such a situation an employee

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79. 1-A A. SUTHERLAND, STATUTORY CONSTRUCTION § 23.06 (4th ed. 1972).

'The rule of strict construction is not violated by permitting the words of the statute to have their full meaning, or the more extended of two meanings, as the wider popular instead of the more narrow technical one; but the words should be taken in such a sense, bent neither one way nor the other, as will best manifest the legislative intent.' In the present case we do nothing to the words of the Act; we merely accept them.

SEC v. C.M. Joiner Leasing Corp., 320 U.S. at 355 (quoting *United States v. Hartwell*, 73 U.S. (6 Wall) 385, 396 (1867)). The *Daniel* court has pursued a similar course. Quite recently the Supreme Court stressed that in interpreting the federal securities laws, "the starting point in every case . . . is the language [of the statute] itself." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976).

80. 120 CONG. REC. 4277-78 (1974). "It is a modest bill. It does not purport to solve every problem." *Id.* at 4278 (remarks of Rep. Perkins).

81. The plan administrator is afforded three months in which to inform the participant concerning the interest for which the participant gives value every day that he works. 29 U.S.C. § 1024(b) (Supp. V 1975).

82. 15 U.S.C. §§ 77b(10), 77g, 77j (1976).

83. ERISA permits an employer to limit pension plan participation to employees aged twenty-five or older. 29 U.S.C. § 1052 (Supp. V 1975). Thus, if an employee goes to work at age eighteen, his employer can legally wait seven years and three months before revealing to him the terms of the plan.

84. Even within the first year, if terminated for a valid business reason, a plan does not retroactively lose its qualified status. *See Kane Chevrolet Co. v. C.I.R.*, 32 T.C. 596 (1959); I.R.C. § 401a.

who is not vested will receive no pension for the labor he has already performed. Under ERISA the employee would be ignorant of the risk. However, if the participant's position as an investor is recognized, then he is entitled at the time of his investment decision to all the protections of the antifraud provisions of the securities laws.<sup>85</sup>

Even though the employer's preference as to setting up a plan may be at odds with the full disclosure to the employee of the risks involved in participating in the plan, the rule of *caveat emptor* should not reward fraud and deception. Congress has repeatedly recognized the importance of disclosure.<sup>86</sup> Moreover, the employer's disclosure must be in such form as to make its significance apparent.<sup>87</sup> Rather than controverting Congressional intent, application of the securities laws to pensions tends to make that intent a reality.<sup>88</sup>

## VI. CONCLUSION

Pension funds have become an investment vehicle for millions of Americans. Although pensions are in some ways dissimilar to stocks and bonds, the most easily recognized forms of securities, the Supreme Court has traditionally considered a host of factors in determining whether an investment is a security, not the least of which is the economic reality underlying the transaction. In reliance on an expected pension benefit, an employee may put aside nothing additional for the future. This "work now, earn later" plan is an investment, involving risks considerably greater than the participant can know, absent the assistance of the federal securities laws. Viable remedial legislation must be capable of wider application than simply to the evil which inspired its enactment. The protections Congress sought for pension plan participants can only be reached through the interaction of the federal securities laws with ERISA.

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85. "Too many people pay money into private pension plans year after year expecting eventually to receive retirement income, and they end up getting nothing." 120 CONG. REC. 4277 (1974) (remarks of Rep. Perkins).

86. See, e.g., Government in the Sunshine Act, 5 U.S.C. §§ 552(a), 552a(b), 556 (1976); Truth in Lending Act, 15 U.S.C. §§ 1601-65 (1976).

87. See *In re Universal Camera Corp.*, 19 S.E.C. 648 (1945); *FTC v. Standard Educ. Soc'y*, 302 U.S. 112, 116 (1937).

88. The securities laws do not enable the SEC to protect investors by forbidding the sale of "bad" securities. Rather, they require disclosure to the investor of the facts he needs to make an informed judgment concerning the nature and quality of the interest being offered. "[O]nce full and fair disclosure has occurred, the fairness of the terms of the transaction is at most a tangential concern of the [securities] statute." *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 478 (1977). In contrast, ERISA has been an attempt to create a means for determining the fairness and reliability of pensions. Only "good" pensions can supposedly qualify for preferential tax treatment under the law.