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THE AFTERMATH OF DANIEL: PRIVATE PENSION PLANS, ERISA, AND THE FEDERAL ANTIFRAUD PROVISIONS

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I. INTRODUCTION

A. The Increasing Importance of Pension Plan Assets

From the standpoint of the whole system of social economy, no employer has a right to engage men in any occupation that ex-

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hausts the individual's industrial life in ten, twenty, or forty years, and then leave the remnant floating on society at large as a derelict at sea.¹

Initially, employees did not have "rights" in employer-established private pension plans. The prevailing view was that the benefits payable under such plans were revocable gifts which were bestowed upon deserving employees by and at the discretion of their employers. Since pension benefits were viewed as gratuities for which employees did not give consideration, employers had absolute discretion to deny the gifts to individual employees for any reason. Employers could terminate an entire pension plan at will, without liability for payment of pension benefits to employees who only held a contingent expectation of receiving payments upon retirement.

Employees acquired rights in private pension plans as a result of the 1948 decision in Inland Steel Co. v. NLRB.² In that case, the United States Court of Appeals for the Seventh Circuit held that an employee's services were given as consideration for his pension interest, and that this pension interest was a mandatory subject of collective bargaining.³ Subsequent to the Inland Steel decision, private pension benefits were no longer considered to be gratuities. Employers could no longer deny pension benefits at will, nor could they terminate entire pension plans without liability to employees and their beneficiaries who were entitled to receive pension benefits.

Today, pension benefits, and the provisions for obtaining irrevocable rights to receive those benefits, are important factors in decisions regarding acceptance or continuation of employment. The cumulative effect of the tremendous increase in the number and proportion of persons over 65,⁴ together with the steady decline in the number and proportion of such persons in the work force,⁵ and the continuously rising inflation rate, has caused employees to look to pension plans as a means of financial security in their old age.⁶

¹ D. MCGILL & D. GRUBBS, FUNDAMENTALS OF PRIVATE PENSIONS 17 (1979).
² 170 F.2d 247 (7th Cir.), cert. denied, 336 U.S. 960 (1948).
³ Id. at 263-64.
⁴ During the period from 1920 to 1978, the number of persons 65 and older increased from 4.9 million to 23.9 million, or from 4.6% to 11.0% of the total population. It is anticipated that by the year 2025, there will be approximately 50.9 million persons in the 65 and older age range, representing from 13.6% to 20.2% of this country's total population. D. MCGILL & D. GRUBBS, supra note 1, at 3-5.
⁵ In 1890 persons 65 and over constituted 3.9% of the total population of this country and 4.3% of the total labor force. By 1976 the same group represented 7.8% of the total population but only 3% of the total labor force. From 1890 to 1976, the percentage of persons 65 and over who were working decreased from 38.7% to 12.4%. Id.
⁶ In 1972 the number of employees covered by pension plans had increas-
Pension plan assets also play a significant role in the nation's securities markets. As of 1979 private pension assets exceeded 280 billion dollars, and represented a major portion of the money used in indirect investments. It is estimated that by 1985 pension assets will have a net value of one trillion dollars and represent one-half of the external capital raised by United States ventures. The increasing importance of pension plan assets, and the abuse and mismanagement of those assets, led Congress to adopt the Welfare and Pension Plan Disclosure Act of 1958 (WPPDA), which was repealed and replaced by the Employee Retirement Income Security Act of 1974 (ERISA), a statute specifically enacted to protect pension plan assets and the interests of employees in those assets. The purpose of this Article is to discuss and analyze the protections provided to pension plan participants by ERISA, to compare ERISA's protections with those ed to a range of 23 million to 30 million from approximately 4 million in 1940 and 9.8 million in 1950. In 1970 approximately 4.7 million retired employees received about $7.4 billion in pension benefits, as compared with an estimated 450,000 retired employees who received approximately $370 million in pension benefits in 1950. See H.R. Rep. No. 807, 93d Cong., 2d Sess. 9-11 (1974).

7. Early in this century, approximately 62% of the money invested in this country was directly invested (i.e., used to purchase corporate securities), while only 38% was invested indirectly (i.e., placed with institutional investors such as banks, insurance companies, mutual funds, and pension funds which made direct investments with the money). By 1962 the amount of money invested directly had fallen to 17% while the amount invested indirectly had risen to 83%. In the indirect investment category, the amount of money invested in pension funds increased from 1/10th of 1% to 27%. Hearings Before the Subcommittee on Fiscal Policy of the Joint Economic Committee, Congress of the United States, 91st Cong., 2d Sess. 17-18, 22 (1970).

8. The value of private pension fund assets increased from approximately $2.4 billion in 1940 to $175 billion in 1974. See D. McGill & D. Grubbs, supra note 1, at 30. By 1979 private pension fund assets were worth $280 billion, while state and local governmental retirement plan funds totaled $130 billion, and federal government pension plan assets, exclusive of the Social Security program, were valued at $55 billion. See 125 Cong. Rec. 6 (1979).

9. In 1958 Congress concluded an investigation which revealed that millions of dollars in pension plan assets had been stolen or embezzled by officers of some unions. It also was discovered that many employee pension plan assets were wasted due to payment of unjustifiably large salaries to plan administrators and union officials, kickbacks, self-dealing by administrators, and failure of administrators to exercise reasonable care and prudence in investing pension funds. See S. Rep. No. 1440, 85th Cong., 2d Sess. 1-4, 11, reprinted in [1958] U.S. Code Cong. & Ad. News 4137-40, 4147.


provided to investors by the federal securities laws, and finally, to determine whether the protections afforded to investors by the antifraud provisions of the federal securities laws are available to pension plan participants to supplement the protections of ERISA.

B. The Protections Provided by ERISA

Prior to the adoption of the WPPDA in 1958, there was no comprehensive federal regulatory scheme for private pension plans. Certain aspects of pension plans were regulated by the Internal Revenue Code (the I.R.C.), section 302(c) of the Labor Management Relations Act of 1947, and the fiduciary responsibility laws of the various states.

The primary purpose of the I.R.C. regulations was to prevent plan administrators from discriminating in favor of officers, highly compensated and key employees, and shareholders of an employer with respect to coverage, financing, and benefits of private pension plans. They were also designed to prevent employers from taking excessive and unjustified federal income tax deductions for their contributions to employee pension plans. The I.R.C. regulations were not concerned with the actuarial soundness of private pension plans or their ability to pay benefits to participants.

Section 302(c) imposed restrictions on private pension plans which were established through multi-employer collective bargaining agreements. The principal restrictions required pension plans to be jointly administered by labor and management trustees for the sole benefit of employees and their beneficiaries. Similar to the I.R.C. regulations, section 302(c) was not concerned with the actuarial soundness of pension plans or their ability to pay benefits to employees upon retirement.

The fiduciary responsibility laws of the states imposed duties of honesty, fairness, and due care upon persons and institutions involved in the management of pension plan assets. State laws, however, provided ineffective and inadequate protection for the assets and interests of participants of plans which operated across state lines.

In 1958 the Senate Committee on Improper Activities in Labor-Management Relations (the Committee) concluded an extensive investigation which uncovered widespread embezzlement, payment of exorbitant salaries, self-dealing, waste, and general mismanagement of some private pension plan assets by their administrators. The Committee concluded that the abuses resulted from the lack of a comprehensive federal statute

which would provide uniform and effective regulation of private pension plans, and which would remedy the almost complete absence of any financial accounting or reporting regarding pension plan assets to participants, beneficiaries, or governmental authorities.

After concluding its investigation, the Committee prepared a report\(^\text{14}\) which recommended the adoption of a federal disclosure act mandating publicly\(^\text{15}\) available information concerning the operation and administration of private pension plans. The report articulated the Committee's belief that public disclosure of pertinent information about private pension plans and their assets would protect the assets and millions of people relying on those assets for future economic security.\(^\text{16}\)

Congress adhered to the Committee's recommendation by adopting the WPPDA,\(^\text{17}\) which was essentially a federal disclosure statute designed to protect pension plan assets from abuse by plan administrators. It was also designed to provide private pension plan participants and their beneficiaries with sufficient information about their pension plans so that they could discover any mismanagement, and if necessary, seek relief for the plan and themselves under applicable federal and state laws. To achieve its purposes, the WPPDA required pension plan administrators to file a description of the plan, annual reports on the operation of the plan, and copies of other pertinent documents concerning the plan with the Secretary of Labor, who was to serve as a mere custodian of the documents. The WPPDA also required plan administrators to make the documents filed with the Secretary of Labor available to plan participants and their beneficiaries, upon request.

A 1962 amendment to the WPPDA\(^\text{18}\) shifted the responsibility for enforcement of its provisions and protection of pension plan assets from the participants themselves to the Justice and Labor Departments of the federal government. The primary objective of the WPPDA, however, continued to be disclosure for the preservation of plan assets rather than for the protection of rights of participants and their beneficiaries to receive pension benefits out of those assets.

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15. The Committee concluded that public disclosure was necessary because private pension plans provided a means of financial security to an increasing number of participants and their dependents, and because the public at large had a vital interest in the large reserves of private pension funds which were invested in the nation's securities markets. Id. at 3-6, reprinted in [1958] U.S. CODE CONG. & AD. NEWS 4140-42. The recognition of a strong public interest in private pension plans was one of the factors which led to the adoption of ERISA. supra note 11.
17. See WPPDA, supra note 10.
In 1964 a report on private employee retirement plans was prepared for President Johnson.\(^{19}\) As a result of the report, Congress began deliberations which led to the awareness that disclosure alone did not guarantee the adequacy of private pension plan reserves for the payment of future retirement benefits. Congress also realized that the WPPDA provided little, if any, protection for the rights of private pension plan participants to actually receive pension benefits.\(^{20}\) It concluded that the disclosure provisions of the WPPDA had to be expanded and supplemented by provisions which clearly defined fiduciary standards for plan administrators; a statute was envisioned which would establish minimum vesting requirements, funding safeguards, participation requirements, and pension plan termination insurance in order to protect the rights of plan participants to receive retirement benefits.

In 1974 Congress repealed the WPPDA and adopted ERISA to protect the rights of employees in private pension plans. ERISA is a comprehensive statute with reporting\(^{21}\) and disclosure\(^{22}\) provisions, in addition to funding

19. See D. MCGILL & D. GRUBBS, supra note 1, at 30 (discussing Public Policy and Private Pension Programs, a Report to the President on Private Employee Retirement Plans by the President’s Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs). The report concluded:

[T]here is a strong public interest in private pension plans because (1) they represent a major element in the economic security of millions of American workers and their families, (2) they are a significant, growing source of economic and financial power, (3) they affect the mobility of the American labor force, and (4) they are subsidized by the general body of taxpayers by virtue of the special tax treatment accorded them. Id. (footnote omitted).

20. Under the WPPDA, supra note 10, it was impossible for many employees to obtain enforceable rights to receive pension benefits because the WPPDA did not proscribe arbitrary and unreasonable vesting requirements or inequitable break-in-service provisions; the latter often caused forfeiture of accrued benefits by participants who had worked for a substantial period of time, but had also experienced a short interruption in service. In addition, the WPPDA’s failure to require pension plans to satisfy minimum funding requirements, and its lack of pension plan termination insurance provisions, resulted in the payment of accrued benefits only to the extent of plan resources upon termination of many plans.

21. ERISA, supra note 11, §§ 101(b), 103(a), 104(a) (codified at 29 U.S.C. §§ 1021(b), 1023(a), 1024(a) (1976)). ERISA requires a pension plan administrator to prepare and file a description and summary of the pension plan and copies of the plan’s annual reports with the Secretary of Labor. The administrator is also required to advise the Secretary of Labor of amendments to the plan in order to keep the information filed current and correct.

22. ERISA, supra note 11, §§ 101(a), 103(a), 104(b), 105(a) (codified at 29 U.S.C. §§ 1021(a), 1023(a), 1024(b), 1025(a) (1976)). ERISA requires a pension plan’s administrator to provide each participant and covered beneficiaries with a
safeguards,\textsuperscript{23} plan termination insurance,\textsuperscript{24} participation and minimum vesting requirements,\textsuperscript{25} and fiduciary standards.\textsuperscript{26} It provides a level of protection for employees' rights in private pension assets that was not provided by its predecessor.

ERISA's reporting provisions require plan administrators to file copies of a summary plan description, the plan's annual report, and other relevant documents with the Secretary of Labor. The summary plan description must be written in a manner to be understood by the average plan participant, and it must be sufficiently accurate and comprehensive to reasonably apprise participants and their beneficiaries of their rights and obligations under the plan.\textsuperscript{27} The annual report must contain an actuarial statement and a financial statement which includes information on the plan's administrative and other expenses, its assets and liabilities, changes in its net assets available for pension benefits, significant changes in the plan's benefits, the number of persons covered by the plan, and transactions involving the plan.\textsuperscript{28}

ERISA's disclosure provisions require plan administrators to furnish each participant and covered beneficiary with a copy of the summary plan description, the annual report, and a statement of vested benefits on an employee's termination of his participation in the plan. Plan administrators must also provide participants and their beneficiaries with a statement of total benefits accrued, nonforfeitable benefits accrued, a copy of bargaining agreements and instruments pursuant to which the plan was established, and other pertinent documents upon request.\textsuperscript{29}

\footnotesize
\begin{itemize}
\item \textsuperscript{23} ERISA, \textit{supra} note 11, §§ 301-302 (codified at 29 U.S.C. §§ 1081-1082 (1976)).
\item \textsuperscript{24} ERISA, \textit{supra} note 11, §§ 4001-4068 (current version at 29 U.S.C. §§ 1301-1368 (1976 & Supp. II 1978)).
\item \textsuperscript{25} ERISA, \textit{supra} note 11, §§ 202-203 (codified at 29 U.S.C. §§ 1052-1053 (1976)).
\item \textsuperscript{26} ERISA, \textit{supra} note 11, §§ 401-414 (codified at 29 U.S.C. §§ 1101-1114 (1976)).
\item \textsuperscript{27} The summary plan description, the annual report, and other documents which are required by ERISA, \textit{supra} note 11, §§ 101-105 (codified at 29 U.S.C. §§ 1021-1025 (1976)), are also regulated by ERISA. ERISA's remedy provisions are available to provide recovery for losses sustained because of false or misleading information in its required documents. \textit{See} note 29 \textit{infra}.
\item \textsuperscript{28} \textit{See} note 27 \textit{supra}.
\item \textsuperscript{29} ERISA's disclosure and reporting provisions regulate the information which must be provided in the required documents to be filed with the Secretary.
\end{itemize}
The funding safeguards provide minimum standards for employer contributions to defined benefit plans, an increase in the maximum federal income tax deduction for employer contributions, more extensive governmental supervision of private pension plans, and the imposition of civil sanctions in addition to loss of qualified status for violation of the funding provisions. Theoretically, the cumulative effect of ERISA's funding safeguards is the assurance of sufficient plan financing and reserves for satisfaction of a plan's pension liabilities to participants and their beneficiaries.

ERISA's plan termination insurance program is administered by the Pension Benefit Guaranty Corporation, and generally applies to defined benefit plans. The insurance program protects pension plan participants and covered beneficiaries by requiring an insurance company to guarantee the payment of vested benefits, up to a designated limit, even if a plan has inadequate funds to meet this obligation at the time of its termination. In effect, plan termination insurance insulates the participants against some of the adverse financial consequences of the plan's termination.

The minimum vesting requirements of ERISA provide alternative schedules for obtaining an enforceable right to receive nonforfeitable pension benefits. Additionally, ERISA's fiduciary standards require trustees of Labor or to be furnished to pension plan participants and covered beneficiaries. A material misstatement or omission of a material fact in these documents constitutes a violation of ERISA's provisions, and the legal and equitable remedy provisions of ERISA are available to provide relief for injuries sustained as a result of false or misleading information contained therein. See ERISA, supra note 11, §§ 404, 409, 501-502 (codified at 29 U.S.C. §§ 1104, 1109, 1131-1132 (1976)).

30. Prior to the adoption of ERISA, a pension plan was required to fund the interest on past service liabilities, but was not required to fund the past service liabilities. As a result, many plans were unable to satisfy past service liabilities when they became due. ERISA's minimum funding standards, ERISA, supra note 11, §§ 301-302 (codified at 29 U.S.C. §§ 1081-1082 (1976)), require that employer contributions to defined benefit plans be sufficient to fund present costs and to amortize past service costs over a maximum number of years in equal annual installments. The funding standards also require pension plans to maintain a funding standard account which contains no accumulated funding deficiency. ERISA defines the accumulated funding deficiency generally as the excess of total charges (including amounts needed to fund present costs and past service liabilities) over the total credits to such account (including employer contributions). For a discussion of defined benefit plans, see text accompanying note 49 infra.

31. Loss of qualified status (i.e., qualification by the IRS) prevents an employer from taking a federal income tax deduction for his contributions to the pension plan, unless they are already vested in the accounts of individual participants. It also prevents an exemption, from current taxation, of the investment earnings on the plan's assets.

32. Cliff vesting provides for 100% vesting of accrued benefits upon completion of 10 years of service. Graded vesting provides for 25% vesting upon com-
to manage pension plan assets in the interest of, and for the sole purpose of, providing pension benefits to participants and their beneficiaries. They must exercise reasonable care, skill, and prudence in managing pension funds; they must diversify plan investments in order to lessen the risk of substantial losses of assets, and they must operate the plan according to its guidelines, which must be consistent with applicable sections of ERISA. The damages recoverable for violation of the fiduciary duties are measured by the losses sustained by the pension plan or the profits realized by the fiduciary, not by restitution or the benefits expected by the participants and covered beneficiaries.33

C. The Protections Provided to Investors by the Federal Securities Acts

The protections provided by ERISA may be adequate for the interest of an employee in some types of pension plans; they are not adequate, however, when an employee's interest in his pension plan is deemed to be a security. In the latter situation, employees should be afforded the same disclosure and antifraud protections which are extended to other investors by the Securities Act of 1933 (1933 Act),34 which regulates offerings of new issues of securities to the public, and the Securities Exchange Act of 1934 (1934 Act),35 which regulates trading of publicly held securities.

ERISA does not provide the same protections as the federal securities acts in several respects. For example, ERISA's disclosure provisions do not require plan administrators to furnish an employee with material information about operation of the plan and payment of pension benefits until 90 days after the employee has made his investment decision (i.e., the decision to participate in the pension plan). As a result of mandating disclosure after the decision to participate in the plan has been made, ERISA requires an employee to make an investment, which significantly affects his future financial security, without the opportunity to obtain sufficient informa-

33. See ERISA, supra note 11, § 409 (codified at 29 U.S.C. § 1109 (1976)).
tion necessary to make a knowing investment decision or to evaluate the risk involved in the investment.

The federal securities laws require disclosure of material information about an issuer and its securities before an investor makes his investment decision and purchases securities. Section 536 of the 1933 Act, in particular, requires any person (i.e., an issuer, underwriter, or dealer) involved in a distribution of a new issue of securities to the public to furnish potential purchasers with a prospectus which gives them certain information about the issuer and the securities before they may be sold. Therefore, the federal securities laws provide greater protection for investors by providing them with sufficient information about the quality and integrity of a company's management, its financial condition, and its securities to enable them to make an informed investment decision and to evaluate the risk of the investment before it is made. In addition to the prospectus delivery requirement, section 5 requires the securities to be registered with the Securities and Exchange Commission (SEC) before they may be offered or sold to the public through the mails or other channels of interstate commerce,37 unless they are specifically exempted from registration.38

The information contained in documents which are required by ERISA is regulated by ERISA. All information in these required documents must be accurate and complete. If required documents contain a material misrepresentation or an omission of material information, a violation of ERISA's provisions has occurred, and its equitable and legal remedy provisions are available to provide relief for injuries sustained as a result of reliance on the misrepresentations.

Although ERISA prohibits misrepresentations in material required by its provisions, it does not provide a general antifraud provision or expressly prohibit misrepresentations or intentionally deceptive statements to pension plan participants or covered beneficiaries when the statements are either made orally or in written material not required by it. There is no remedy for injuries sustained because of misleading or false statements made in connection with the pension plan, its assets, or the interests of par-

37. Any person who sustains damages because of the purchase of securities which were not registered as required by § 5 is entitled to recovery for his damages under § 12(1) of the 1933 Act, 15 U.S.C. § 77l (1976).
38. Specific exemptions are provided in §§ 3-4 of the 1933 Act, 15 U.S.C. §§ 77c-77d (1976 & Supp. III 1979). More specifically, § 3(a)(9) provides an exemption for mergers and reorganizations; § 3(b) provides an exemption for small offerings; and §§ 4(1) and 4(3) provide an exemption for sales by persons other than issuers, underwriters, or dealers engaged in a distribution of securities to the public.
participants or beneficiaries, if the statements were oral or contained in docu-
ments other than those required by ERISA. ERISA appears to place an
affirmative obligation on participants and beneficiaries to compare the in-
formation contained in the required documents to information received
from other sources, and to rely only on information in the required docu-
ments when other information conflicts with that in the required docu-
ments.

The federal securities laws contain several express provisions which
prohibit fraudulent, false, or misleading statements or practices in con-
nection with the purchase or sale of securities, and which provide rights of
recovery for investors who suffer losses because of such acts. Section 17(a)\(^39\)
of the 1933 Act expressly prohibits fraud by making it unlawful for any
person to engage in any fraudulent or deceptive practices in connection
with the offer or sale of securities, whether or not they are required to be
registered under section 5. Similar express antifraud provisions are set
forth in section 10(b)\(^40\) of the 1934 Act and in SEC rule 10b-5\(^41\) promul-

39. 15 U.S.C. § 77q(a) (1976) provides:

It shall be unlawful for any person in the offer or sale of any securities
by the use of any means or instruments of transportation or communica-
tion in interstate commerce or by the use of the mails, directly or in-
directly—

(1) to employ any device, scheme, or artifice to defraud, or
(2) to obtain money or property by means of any untrue statement
of a material fact or any omission to state a material fact necessary in
order to make the statements made, in the light of the circumstances
under which they were made, not misleading, or
(3) to engage in any transaction, practice, or course of business
which operates or would operate as a fraud or deceit upon the purchaser.

40. 15 U.S.C. § 78j(b) (1976) provides:

It shall be unlawful for any person, directly or indirectly, by the use
of any means or instrumentality of interstate commerce or of the mails,
or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any
security . . . any manipulative or deceptive device or contrivance in con-
travention of such rules and regulations as the Commission may pre-
scribe as necessary or appropriate in the public interest or for the protec-
tion of investors.

41. 17 C.F.R. § 240.10b-5 (1980) provides:

It shall be unlawful for any person, directly or indirectly, by the use
of any means or instrumentality of interstate commerce, or of the mails
or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to
state a material fact necessary in order to make the statements made, in
the light of the circumstances under which they were made, not mislead-
ing, or
gated thereunder. Specifically, section 10(b) and rule 10b-5 prohibit fraud, deceit, or manipulative or deceptive practices in connection with the purchase or sale of securities.

Sections 1142 and 1243 of the 1933 Act further protect investors by providing recovery for individual investors injured because of materially false or misleading statements made in connection with the purchase of securities. If a registration statement contained an untrue statement of a material fact or an omission of a material fact, section 11 expressly provides for recovery of damages by any person who was injured as a result of purchasing securities offered under that registration statement. Section 12(2) expressly provides for recovery of damages against the person who actually sold an investor a security by means of a prospectus or oral communication which included a false statement of a material fact or an omission of a material fact, whether or not the security was required to be registered under section 5. Investors are also entitled to recover damages for injuries sustained in the purchase or sale of securities under rule 10b-5.44

When the interest of an employee in his pension plan is a security, he needs and deserves the same protections which are accorded to other investors by the federal securities laws. He needs information about the quality and integrity of the plan's administrators and the trustees who handle its assets before he makes an investment by becoming a participant in the plan. He also needs information about the operation of the plan, its vesting requirements, the number of participants, its actuarial assumptions, its assets, its prospective income, and other pertinent information in order to determine if the plan sufficiently guarantees payment of future retirement benefits. More importantly, the employee needs the protections provided by the federal antifraud provisions to assure that none of the information furnished contains materially false, misleading, or fraudulent statements, or material omissions of information; the employee should also be provided with a remedy for recovery of any damages he sustains if the information he receives does contain such statements.

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

II. THE APPLICABILITY OF THE FEDERAL ANTIFRAUD LAWS TO PRIVATE PENSION PLANS

A. Types of Employee Pension Plans

The applicability of the federal securities laws to employee pension plans is not addressed in any section of the 1933 Act, the 1934 Act, or in the legislative history of either Act. As a result of Congress' silence, the United States Supreme Court\(^45\) and other federal courts\(^46\) have attempted to resolve the issue. The issue, however, has not been entirely disposed of by the courts;\(^47\) it therefore remains open for discussion and resolution.

The remainder of this Article will be limited to a discussion of the applicability of the antifraud provisions of the 1933 and 1934 Acts to private employee pension plans. The particular issue to be analyzed is whether the acquisition of an interest by an employee in a private pension plan constitutes the purchase of a security in the form of an investment contract, and assuming an answer in the affirmative, whether that interest is entitled to the protections of the antifraud provisions of the federal securities laws. The disposition of this issue requires a discussion of the various types of employee pension plans, as well as an examination of the following key issues: the terms "security" and "investment contract;" the *International Brotherhood of Teamsters v. Daniel*\(^48\) case; interests in private pension plans which are not securities under the *Daniel* holding; interests in private pension plans which are securities under *Daniel*; and ERISA's impact on the applicability of the federal antifraud provisions to interests in private pension plans which are securities.

Employee pension plans are classified as noncontributory or contributory according to the method by which they are financed. Noncontributory plans are financed entirely by employer contributions to the pension plan. Employees who participate in noncontributory plans do not make monetary payments into the fund from which pension benefits are paid. Contributory plans are either financed entirely by employee contributions


\(^{47}\) The courts' decisions have been confined to the applicability of the antifraud provisions to *involuntary* plans, both noncontributory and contributory, and to defined benefit plans. For explanations of the various types of employee pension plans, see text accompanying notes 49-51 infra.

\(^{48}\) 439 U.S. 551 (1979).
to the pension plan, or they are financed jointly by employer and employee contributions.

In addition to classification based on the method of financing, employee pension plans are further categorized as defined benefit or defined contribution according to the type of pension benefits paid to the participants. Defined benefit plans do not subject participants to a "risk" with respect to the level of future retirement benefits they will receive. In defined benefit plans, the level of benefits to be received by vested participants upon their retirement is predetermined, and employers undertake to provide a fixed amount of benefits in accordance with specific schedules. The only variable in defined benefit plans is the level of contributions to the plan. The contributions are determined by a formula based on the rate of return on the plan's investments, estimated employee attrition, mortality rates, employee retirement ages, and other actuarially computed calculations. For example, if the assets of a noncontributory defined benefit pension plan are inadequate to pay the fixed level of benefits to employees as they retire, without jeopardizing the payment of benefits to future and antecedent retirees, the employer must make additional contributions to make up the difference. If, on the other hand, the plan's assets are greater than anticipated (i.e., because the investment success of the plan resulted in tremendous earnings), the employer's contributions are reduced. A defined benefit plan confers the risk of insufficient reserves to meet its liabilities, as well as the benefits of greater reserves due in part to returns on investments, on employers rather than employee-participants.

Retirement benefits payable under a defined contribution plan are treated as variable, but the contributions are fixed. For example, in a noncontributory defined contribution plan, the employer undertakes to make payments to the pension plan on a specified basis, but he does not undertake to provide retirement benefits in accordance with a predetermined scale. The benefits which a participant will eventually receive fluctuate with and are determined by factors such as the plan's investment success, the amount of contributions paid into the plan, the amount of benefits paid out, and the amount of benefits forfeited by participants who do not satisfy the vesting requirements.

49. Vested participants are assured payment of retirement benefits as either a flat benefit which is a stated amount per month, or a fixed benefit which is a specified percentage of their income, or a unit benefit which is a specified percentage of their salary multiplied by their individual years of service.

50. If employees make contributions to the pension fund (i.e., a contributory plan), their contributions and the interest earned thereon are nonforfeitable. A record of individual contributions must be maintained so that the plan can return accrued benefits in full to nonvested employees who terminate their participation. If employees die while still participating in the plan, their contributions and interest must be paid to designated beneficiaries or to the employees' estates if no beneficiaries were designated. Any plan which does not comply with
Unlike defined benefit plans, participants in defined contribution plans bear the risk and reap the benefits of the plan's operations. When there is an unanticipated reduction in the plan's assets, there is a corresponding reduction in pension benefits paid out. But when the assets in a defined contribution plan are increased due to the plan's investment success or other reasons, pension benefit payments increase correspondingly. Individual accounts are established and maintained for each participant in a defined contribution plan to reflect his share in the plan's assets. The accounts are adjusted periodically to reflect changes in each participant's share of the plan's assets based on contributions, forfeitures, and paid-out benefits, as well as earnings and losses on the plan's investments. Upon retirement, each participant receives benefits on the basis of the amount accumulated in his individual account.

An employee may or may not have an option with respect to participation in his pension plan. If he has discretion regarding participation (i.e., he makes an independent decision whether to participate or not), the plan is voluntary. If, on the other hand, participation in a pension plan is mandatory so that an employee does not have discretion concerning his participation, the plan is involuntary. All of the above factors—method of financing, payment of benefits, and discretion with respect to participation—may be combined to produce several types of employee pension plans.  

B. What is a Security in the Form of an Investment Contract?

Sections 2(1) of the 1933 Act and 3(a)(10) of the 1934 Act define the term "security" to mean "any note, stock, treasury stock, bond, . . . [or] in-

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51. The possible combinations of employee pension plans are as follows: involuntary, noncontributory and defined benefit; involuntary, noncontributory and defined contribution; involuntary, contributory and defined benefit; involuntary, contributory and defined contribution; voluntary, noncontributory and defined benefit; voluntary, noncontributory and defined contribution; voluntary, contributory and defined benefit; and voluntary, contributory and defined contribution.


53. 15 U.S.C. § 78c(a)(10) (1976) provides: "The term 'security' means any note, stock, treasury stock, bond, . . . investment contract, . . . or in general, any instrument commonly known as a 'security'. . . ." Although not discussed in this Article, an employee's interest in a private pension plan can also constitute a security in the form of a profit-sharing agreement.
vestment contract.” The term “investment contract” has traditionally been broadly interpreted by the Supreme Court and other federal courts.

In SEC v. C.M. Joiner Leasing Corp., 54 the SEC brought an action to enjoin the defendants from violating the 1933 Act. The defendants, lessors of certain tracts of land in Texas, were required by the terms of their leases to drill test wells to determine the oil producing possibility of the land. To raise capital to finance the drilling, they engaged in a campaign to sell assignments of the oil and gas leases to the public. The United States District Court for the Northern District of Texas and the United States Court of Appeals for the Fifth Circuit refused to issue the injunction after finding that the oil and gas leases were interests in land and were not securities in the form of investment contracts. 55 The Supreme Court, however, applied the “economic interest” test and held that the defendants were selling unregistered, nonexempt securities to the public, and issued the injunction. 56 It found that misleading sales literature had been used to emphasize the economic inducements of the proposed exploratory drilling of test wells on the land being offered, and that the economic interest in the test wells to be drilled provided most of the value to the leases because the land could not be used for other purposes. Based on its findings and application of the “economic interest” test, the Court ruled that the sale of the leases did, in fact, constitute the sale of investment contracts rather than interests in land. 57

In the Joiner decision, the Supreme Court used a subjective test in defining the term “investment contract.” The Court, however, did provide objective criteria to be used in determining when a venture or scheme involves the sale of an investment contract in SEC v. W.J. Howey Co. 58 That case involved an action by the SEC to enjoin the defendant, Howey Co., from using the mails and other channels of interstate commerce to offer and sell unregistered and nonexempt securities to the public in violation of section 5 of the 1933 Act.

Howey Co. was engaged in an offering of a portion of its citrus acreage in Lake County, Florida, to raise money to finance development of other land retained by it. The company offered purchasers a land sales contract, a deed, and a service contract under which labor and materials were provided for development, cultivation, harvesting, and marketing of the purchaser’s land and crops, and remission of net profits to the purchasers.

The United States District Court for the Southern District of Florida denied the injunction sought by the SEC, 59 and the Fifth Circuit af-

54. 320 U.S. 344 (1943).
55. 133 F.2d 241 (5th Cir.), rev’d, 320 U.S. 344 (1943).
56. 320 U.S. at 349.
57. Id.
58. 328 U.S. 293 (1946).
59. 60 F. Supp. 440 (S.D. Fla.), aff’d, 151 F.2d 714 (5th Cir. 1945), rev’d, 328 U.S. 293 (1946).
firmed, on the ground that the offer and sale of the documents constituted an offer and sale of interests in land rather than investment contracts. The Supreme Court granted certiorari and reversed after finding that the purchasers put up capital, that the promoters managed, controlled, and operated the business, and finally, that the purchasers shared in the earnings and profits realized from the promoters’ efforts. These factors were all considered by the Court to be “elements of an investment contract.” It stated that the test of a security in the form of an investment contract is whether a contract, transaction, or scheme exists by which a person invests his money in a common enterprise with the expectation of receiving profits from the management and entrepreneurial efforts of others.

The Supreme Court applied the objective criteria set forth in Howey in United Housing Foundation, Inc. v. Forman. In Forman, the Court held that the sale of shares of stock which entitled the purchasers to lease apartments in a state-subsidized and supervised, nonprofit, cooperative apartment complex did not constitute the sale of securities for purposes of the federal securities laws. The Court reasoned that the purchasers’ interests in the cooperative housing complex were not investment contracts because their sole purpose for buying the shares of stock was to acquire a place to live. Since the tenants did not purchase the stock as an investment in the corporation, and since they held no expectation of profits or dividends to be earned through the management or entrepreneurial efforts of others, the Howey test was not satisfied.

The Court’s failure to find the sale of investment contracts in Forman does not signal the end of the traditionally broad interpretation of the term “investment contract” or the beginning of a trend of a strict interpretation. The decision was simply based on two findings: first, the purchasers bought the shares of stock because it was the only way to obtain leases which conferred the right to occupy apartments in the cooperative complex; and second, the purchasers held absolutely no expectation of receiving profits in the form of dividends or interest payments. The sale of investment contracts could not have been found under any interpretation of the Howey test in the absence of an expectation of profits in connection with the stock purchases.

The United States Court of Appeals for the Fifth Circuit further defined the Howey test in SEC v. Koscot Interplanetary, Inc. Koscot involved a pyramid promotional scheme for the distribution of cosmetics. The scheme was a profit-sharing arrangement in which distributors

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60. 151 F.2d 714 (5th Cir. 1945), rev’d, 328 U.S. 293 (1946).
61. 328 U.S. at 301.
62. Id. at 298-99.
63. Id.
64. 421 U.S. 837 (1975).
65. 497 F.2d 473 (5th Cir. 1974).
invested money and purchased cosmetics for sale and distribution to supervisors and retail managers who, in turn, resold the cosmetics to beauty advisors who derived income from resale of the cosmetics to public customers. The United States District Court for the Northern District of Georgia refused to grant an injunction sought by the SEC to restrain Koscot from offering and selling allegedly unregistered, nonexempt securities in violation of section 5 of the 1933 Act and the federal antifraud provisions. It concluded that the third element of the Howey test, which requires the expectation of profits from the efforts of others, was missing. The court's decision was based on its dual finding that all investors expended efforts in soliciting recruits to attend sales meetings, and that all investors participated in the sale of distributorships and in the retail sales efforts. The case was appealed to the Fifth Circuit, which followed the tradition of the Supreme Court and gave a liberal construction to the "profits from the efforts of others" test. It stated that the efforts of others must be a substantial factor in managing the enterprise and earning profits, but not the sole factor. The Fifth Circuit held that the third element of the Howey test was satisfied because the efforts made by persons other than the investor were the significant efforts which affected the failure or success of the promotional scheme.

III. INTERNATIONAL BROTHERHOOD OF TEAMSTERS v. DANIEL

A. A Review of the Daniel Decision

In its epochal January 16, 1979, decision in International Brotherhood of Teamsters v. Daniel, the United States Supreme Court held that an employee's participation in an involuntary, noncontributory pension plan does not constitute the sale of a security in the form of an investment contract within the definition of Howey, or the 1933 or 1934 Acts. Therefore, the Court held that federal antifraud provisions are not available to give defrauded pension fund participants a right of action in federal courts.

The pension plan and pension trust fund in the Daniel case were established in 1954 pursuant to a pension fund trust agreement resulting from a multi-employer collective bargaining agreement between Local 705 of the

67. Id. at 591-92.
68. 497 F.2d at 485.
70. Id. at 559, 569-70.
International Brotherhood of Teamsters (Local 705) and trucking firms in the Chicago area. The agreement provided for payment of pension benefits from the Local 705 Pension Trust Fund (the Fund) to employees who retired after twenty years of consecutive, continuous, and uninterrupted service with companies participating in the collective bargaining agreement. The fund derived all of its revenue from contributions by each contractor-employer at a specified amount per week for each week of employment by a union member in its employ.

John Daniel, a member of Local 705, retired after accumulating more than twenty-two years of service with employers covered by the collective bargaining agreement. His application for pension benefits was denied by the pension plan’s administrator because of an involuntary break in service due to a lay off from December of 1960 to April of 1961. Following the refusal of the Fund’s trustees to reverse the decision denying him pension benefits, Daniel filed a complaint in the United States District Court for the Northern District of Illinois. He alleged that the defendants—Local 705, the International Brotherhood of Teamsters, and a trustee of the Fund—had misrepresented and failed to state material facts regarding the value of his interest in the Fund. More specifically, he alleged: (1) the pension plan booklets describing the Local 705 pension plan misrepresented the length and continuity requirements for satisfying the vesting provisions and receiving retirement benefits; (2) failed to advise employees that they would not receive retirement benefits if they failed to satisfy the vesting provisions; (3) failed to advise employees that contributions made on their behalf into the pension fund and the earnings accumulated on the contributions would be forfeited if employees did not satisfy the vesting requirements; and (4) failed to disclose the actuarial basis used by the plan and the actuarial likelihood for receipt of retirement benefits.

Daniel further alleged that the misstatements and omissions constituted a fraud in connection with the offer and sale of securities to the public, violating section 17(a) of the 1933 Act,71 section 10(b) of the 1934 Act,72 and rule 10b-5 promulgated thereunder.73 Finally, Daniel contended that he purchased a security in the form of an interest in the Fund by providing labor services to an employer under a labor contract with the Teamsters, and that he sustained substantial losses as a result of the defendants’ fraudulent omissions and misstatements in connection with the sale of that security.

The United States District Court for the Northern District of Illinois denied the defendants’ motion to dismiss the complaint for failure to state a cause of action or ground for relief in federal court,74 and the Seventh

73. 17 C.F.R. § 240.10b-5 (1980).
Circuit affirmed. In their motion, the defendants alleged that Daniel's interest in the Fund was not a security, that he did not acquire his interest in a sale, and that ERISA preempted application of the federal securities laws to employee pension plans. Both courts denied the defendants' motion to dismiss for lack of subject matter jurisdiction. They found that Daniel's interest in the Fund was a security in the form of an investment contract, that he had acquired the security in a sale, and that since the federal securities laws were involved in the sale, Daniel had a right to pursue his action in federal court.

The courts' finding that Daniel's interest in the Fund was an investment contract was based on the following reasoning: (1) Daniel's employer invested money into the Fund on his behalf; (2) the employer's contributions were a form of compensation for Daniel's services; (3) the Fund received contributions on behalf of Daniel and other employees, and thus qualified as a common enterprise; (4) the Fund was managed by persons other than Daniel and the other employees on whose behalf contributions were made; and (5) profits were expected from the investment in the common enterprise because the anticipated retirement benefits would exceed contributions (i.e., the gain or increase over the amount of contributions made on behalf of an employee was deemed to be a profit). The courts' finding that a "sale" of a security had been made to Daniel within the meaning of section 2(3) of the 1933 Act, and section 3(a)(14) of the 1934 Act was based on the rationale that Daniel gave consideration for his interest in the pension plan by ratifying the Local 705 Pension Fund Trust Agreement and by remaining an employee of an employer which was covered by the agreement. By finding that Daniel's acquisition of an interest in the Fund constituted the sale of a security in the form of an investment contract, the district court and the court of appeals both concluded that Daniel was an investor who needed and deserved the protections of the federal antifraud provisions.

The Supreme Court granted certiorari and reversed the decisions of the district court and the court of appeals. It held that Daniel's interest in

75. 561 F.2d 1223 (7th Cir. 1977), rev'd, 439 U.S. 551 (1979).
76. Id. at 1230-31; 410 F. Supp. at 552. The Seventh Circuit held that an employee's interest in a noncontributory, compulsory plan constitutes a security for purposes of the antifraud provisions of the federal securities acts, but not for the registration provisions of those acts. 561 F.2d at 1241-42.
77. 561 F.2d at 1231-38; 410 F. Supp. at 549-52.
78. 15 U.S.C. § 77b(3) (1976) provides in part: "The term 'sale' and 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value."
79. 15 U.S.C. § 78c(a)(14) (1976) provides: "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."
80. 561 F.2d at 1242-43; 410 F. Supp. at 552-54.
81. 439 U.S. at 557.
the Local 705 involuntary, noncontributory pension plan did not constitute a security for the following reasons: (1) he did not make a specific monetary or other tangible investment into the Fund; (2) his labor was given solely in exchange for wages and not for the purpose of making an investment; (3) he did not have the option to demand that the employers' contribution to the Fund be paid to him as additional wages or other benefits as a substitute for pension eligibility; (4) he was required to participate in the pension plan and therefore did not make an independent investment decision; and (5) he did not invest in a common enterprise with an expectation of profits to be derived from the entrepreneurial efforts and successful management of the Fund's assets by the trustees, since the largest portion of the Fund's income was directly traceable to employer contributions, and realization of pension benefits was principally determined by an employee's satisfaction of substantial preconditions to vesting rather than earnings from the Fund's assets.

After holding that the terms "investment contract" or "security" as defined in the 1933 and 1934 Acts do not apply to involuntary, noncontributory pension plans, the Supreme Court in dicta implied that Congress, by enactment of ERISA, had obviated the necessity for, and had preempted application of the federal securities laws to employee pension plans. The Court stated:

The existence of this comprehensive legislation [ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. . . . Not only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA it serves no general purpose . . . . Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA.\(^82\)

A broad interpretation of the Daniel dicta is inconsistent with ERISA's savings clauses.\(^83\) The Daniel dicta also completely disregards the fact that some types of employee pension plans involve the sale of securities to the public, and that participants in those plans need the protections of the antifraud provisions of the federal securities laws.

B. Interest in Employee Pension Plans which are not Securities under Daniel

The Supreme Court's decision in Daniel was limited to the issue presented: does acquisition of an interest in an involuntary, noncontributory

\(^82\) Id. at 569-70 (citations omitted).

\(^83\) See notes 90-92 and accompanying text infra.
employee pension plan involve the sale of a security in the form of an investment contract, and is that interest subject to the antifraud provisions of the federal securities laws? The Court answered in the negative because it found that the employees were given neither discretion regarding participation in the plan nor the opportunity to make a tangible payment into the Fund. It noted that Daniel and other participants were prevented from making an independent decision to invest, and that they were denied the opportunity to make a tangible investment into the Fund. Finally, the Court held that in the absence of either an independent investment decision or a tangible investment, a sale of a security is not involved, and that the federal antifraud provisions are therefore not applicable.

Under the Daniel decision, an employee's interest in any pension plan which is either involuntary or noncontributory is not a security. The Daniel decision does not address the issue of whether an employee's interest in a voluntary, contributory plan is a security, and whether the federal antifraud provisions are applicable to that interest. In this author's opinion, some voluntary, contributory plans do involve the sale of a security, and their participants and covered beneficiaries are entitled to the protections of the federal antifraud laws.

The interest of an employee in a voluntary, contributory defined benefit plan appears to be a security in the form of an investment contract. It certainly satisfies the first two elements of the Howey test and critical components of the Daniel approach, since the employee makes an independent decision to participate in the plan and invests his money into a fund which is a common enterprise. An employee's interest in a voluntary, contributory defined benefit plan, however, is not a security because the third element of the Howey test is missing. Specifically, there is no expectation of profits from the efforts of others (i.e., the trustees who handle the fund's assets).

Defined benefit plans do not depend on the efforts of others in generating investment earnings on the plan's assets in order to pay fixed pension benefits to participants. Furthermore, participants in defined benefit plans do not experience a risk in connection with their investment because the employer must make sufficient contributions to the fund to guarantee and pay the fixed level of retirement benefits to all vested participants.

84. Although the pension plan in Daniel was also a defined benefit plan, the Court's decision was not based on that aspect of the plan.
85. See Black v. Payne, 591 F.2d 83 (9th Cir.), cert. denied, 444 U.S. 867 (1979), where the Ninth Circuit held that the Daniel decision prevents an employee's interest in an involuntary, contributory pension plan from satisfying the definition of an investment contract.
C. Interests in Employee Pension Plans which are Securities under Daniel

The interest of an employee in a voluntary, contributory defined contribution plan is a security. It does not fall within the scope of the Daniel decision, and it satisfies the Howey test. The participating employee makes an independent decision to invest his money, and this investment is a specific, quantifiable consideration in the pension fund, as opposed to other investment media. The pension fund qualifies as a common enterprise in which each participant acquires a separable interest which is reflected in an individual account. Perhaps most important, each participant reasonably expects a return on his investment,\(^\text{87}\) in the form of variable future pension benefits, which exceeds his total contributions to the pension fund. This expectation arises primarily because of anticipated investment earnings on the plan's assets realized through the managerial and entrepreneurial efforts of the plan's trustees.

D. Does ERISA Preempt Application of the Federal Antifraud Provisions to Employee Interests in Voluntary, Contributory Pension Plans?

A disposition of a security, as defined by section 2(3) of the 1933 Act,\(^\text{88}\) and section 3(a)(14) of the 1934 Act,\(^\text{89}\) is made when an employee becomes a participant in and contributes to a voluntary, contributory defined contribution plan. Therefore, acquisition of an interest in this type of plan is deemed to be a sale within the meaning of the federal securities acts, and is subject to the federal antifraud provisions. Since an employee who participates in a voluntary, contributory defined contribution plan purchases a security, he is entitled to the protections of the federal antifraud provisions, unless ERISA preempts their application.

\(^\text{87}\) Unlike the pre-ERISA 20-year vesting requirements, pension plans established under ERISA must contain minimum standards for participation in the plan and for vesting (i.e., schedules under which pension benefits become nonforfeitable and under which participants are given a reasonable expectation rather than a mere contingent expectancy of receiving future pension benefits). See ERISA, supra note 11, §§ 202-203 (codified at 29 U.S.C. §§ 1052-1053 (1976)). ERISA's relaxed and graduated vesting provisions, plan termination insurance provisions, and funding requirements also help to provide a reasonable expectation of receiving future benefits from the pension fund's assets. See notes 23-26 and accompanying text supra.


ERISA does not preempt application of the federal securities laws to voluntary, contributory defined contribution plans or any other type of employee pension plans. On the contrary, ERISA preserved the federal securities laws in section 514(d), which provides: "Nothing 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 any such law."90 In addition to preserving the federal securities laws, Congress may have considered placing the administration of ERISA with the SEC. Since the SEC was unwilling to supervise compliance with the WPPDA,91 however, Congress may have concluded that the SEC would also be unwilling to supervise compliance with ERISA.

Although section 514(a)92 of ERISA preempted state regulatory statutes which interfere with the federal regulatory scheme for pension plans, ERISA expressly preserved state securities laws which are generally similar to the federal securities laws. Section 514(b)(2)(A) of ERISA provides: "Except as provided in subparagraph (B), nothing in this title shall be construed to exempt or relieve any person from any law of any State which regulates insurance, banking, or securities."93

IV. CONCLUSION

In the aftermath of the Supreme Court's decision in Daniel, both Congress94 and the SEC95 are attempting to clarify the applicability of state

91. Serious consideration was given to placing the administration of the WPPDA with the SEC on the basis of its past experience in the administration of disclosure type legislation. However, as the official representatives of the SEC clearly indicated that they did not feel they were the proper agency to handle the administration of this type of legislation, and as they felt that the taking on of this function might interfere with their presently established functions, this consideration was abandoned. S. REP. NO. 1440, 85th Cong., 2d Sess. 21, reprinted in [1958] U.S. CODE CONG. & AD. NEWS 4137, 4156.
92. 29 U.S.C. § 1144(a) (1976) provides: "Except as provided in subsection (b) of this section, the provision of this subchapter and subchapter III of this chapter shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan described in section 1003(a) . . . and not exempt under section 1003(b) . . . ."
and federal securities laws to all employee pension plans which are subject to and governed by ERISA. In 1978\textsuperscript{96} and again in 1979,\textsuperscript{97} a bill was introduced in Congress to amend ERISA. The proposed ERISA Improvements Act of 1979 would add new sections\textsuperscript{98} to ERISA which prohibit an administrator, fiduciary, plan sponsor, or any other person from "knowingly" misrepresenting information about a pension plan, its assets, or a participant's interest therein. The new sections also provide a remedy to persons who are deceived and injured by a knowing misrepresentation. The net effect of these new sections appears to obviate the necessity for applying the antifraud provisions of the federal securities laws to interests in employee pension plans, since the primary purpose for applying these laws is to provide a remedy to persons injured by misrepresentations or fraudulent statements made either orally or in documents not required by ERISA.

In the "Summary and Analysis of Consideration of the ERISA Improvements Act of 1979" (S. 209), the Senate Committee on Labor and Human Resources unequivocally expressed its intent that the amendments would prospectively preempt application of the antifraud provisions of the federal and state securities laws to pension plans. It stated:

Section 154(a) amends ERISA Section 514 to clarify that the antifraud provisions of the Federal securities laws and all provisions of state securities laws shall not apply prospectively to the relationship between a plan or plan sponsor and an employee. Section 153(7) renders nugatory any litigation based on an act or omission occurring on or after the date of enactment of the bill insofar as it alleges that the relationship between a plan or plan sponsor and an employee may serve as the basis for a claim under the Federal securities laws' antifraud provisions or under any provision of state securities laws.

... The amendments made by the ERISA Improvements Act do not disturb in any way the application of the 1933 and 1934 Acts to transactions involving the issuance, sale or purchase of securities between plans and plan sponsors... nor do they affect in any way the definition of the term 'security' in connection with


\textsuperscript{98} Section 154(b) of the ERISA Improvements Act of 1979 adds the following new § 515(a) which prohibits certain misrepresentations in connection with employee benefit plans: "It shall be unlawful for any person to knowingly misrepresent the terms and conditions of an employee benefit plan, the financial condition of a plan, or the status under the plan of any employee, participant or beneficiary." 96 Cong. Rec. at S564. Additionally, section 153(2) of the bill amends ERISA, supra note 11, § 502 (codified at 29 U.S.C. § 1132 (1976)), to provide a remedy for participants who rely on misrepresentations (prohibited by new § 515) to their detriment. 96 Cong. Rec. at S564.
such transactions. However, the amendments provide that the interests of an employee in a plan is not to be considered to be a security for purposes of the antifraud rules of the 1933 and 1934 Acts and within the meaning of any provision of a state securities law. The application of the 1933 and 1934 Acts' antifraud rules to the relationship of an employee to a multiemployer plan and one of its sponsors, a local union, was the subject of recent Supreme Court litigation. In . . . [the Daniel case], the Court ruled unanimously that the antifraud rules did not apply. The decision is largely consistent with the Committee's views as regards defined benefit plans in which participation is mandatory, but the amendments in S. 209 extend the Daniel case result to all employee benefit plans which are subject to title I of ERISA.99

In S. 209, Congress clarifies any ambiguity regarding ERISA's prospective preemption of the antifraud provisions to employee pension plans, as well as ERISA's prospective effect on the registration provisions100 of the 1933 and 1934 Acts as applied to employee pension plans. The Committee on Labor and Human Resources statement that the amendments proposed by S. 209 appear to "extend the Daniel case result to all employee benefit plans which are subject to title I of ERISA" supports the inference that ERISA, as adopted, does not preempt the application of the antifraud rules to all employee pension plans, and that Daniel only preempts the application of the antifraud rules to involuntary, noncontributory plans.

On February 11, 1980, the SEC issued a release101 in which it reaffirmed its adherence to its previously stated position that (1) employee interests in voluntary, contributory pension plans are securities in the form of investment contracts, (2) that a sale of a security, as defined by the federal securities acts, takes place when participants acquire interests in voluntary, contributory pension plans, and (3) that ERISA does not preempt application of the federal securities laws antifraud provisions to such interests. The SEC position is correct insofar as voluntary, contributory defined contribution plans are concerned. As stated above,102 employee interests in voluntary, contributory defined benefit plans do not satisfy the


100. This Article is limited to a discussion of the antifraud provisions. It should be noted, however, that S. 209 preserves § 5 of the 1933 Act, which requires issuers to register securities with the SEC before they may be offered or sold to the public through use of the mails or other channels of interstate commerce, unless such securities satisfy certain requirements for exemption from registration. See 15 U.S.C. § 77e (1976).


102. See note 86 and accompanying text supra.
Howey test of an investment contract; they are therefore not securities and a sale of securities is not involved in their acquisition.

If S. 209 is enacted by Congress, the SEC position will become moot. Congress will have spoken the final word, and the interests of participants in all categories of employee pension plans which are subject to ERISA will not be considered securities for the purpose of the antifraud provisions of the federal securities laws. S. 209 will supersede federal and state antifraud laws, and will prospectively preempt their application to employee interests in all pension plans, including those which are voluntary, contributory defined contribution plans. S. 209 will operate to deny the protections of the federal antifraud protections to some classes of investors, while ostensibly substituting equivalent protections under new sections added to ERISA.