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Case Note: Securities Law - Pensions - An Involuntary Noncontributory Employee Pension Fund is a "Security" Under the Federal Securities Laws

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SECURITIES LAW—Pensions—An Involuntary Noncontributory Employee Pension Fund is a "Security" Under the Federal Securities Laws. *Daniel v. International Brotherhood of Teamsters*, 410 F. Supp. 541 (N.D. Ill. 1976), *appeal docketed*, No. 76-1855 (7th Cir. April 29, 1976).

Plaintiff union member John Daniel was denied the right to receive union pension benefits after working for twenty-two and one-half years.[1] The trustees of the Local 705 Fund denied the benefits[2] because Daniel's employment was not continuous.[3] They contended that Daniel did not meet the conditions of the union pension plan, since he had been laid off involuntarily for several months.[4] As a result, Daniel brought a class action under the antifraud provisions of the federal securities laws[5] on behalf of all present and past Teamster members against the trustees of Local 705 pension plan, Local 705, certain Local officers and the International Brotherhood of Teamsters. Daniel alleged that defendants had violated section 17a of the Securities Act of 1933 (Securities Act)[6] and section 10b of the Securities Exchange Act of 1934 (Exchange Act),[7] in the offer

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1. Daniel v. International Bhd. of Teamsters, 410 F. Supp. 541, 543 (N.D. Ill. 1976), *appeal docketed*, No. 76-1855 (7th Cir. April 29, 1976).

2. *Id.* at 543.

3. *Id.*

4. *Id.*

5. *Id.* The specific statutes are the Securities Act of 1933, 15 U.S.C. §§ 77a-aa (1970) [hereinafter cited as the Securities Act]; and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-j (1970) [hereinafter cited as the Exchange Act].

6. 15 U.S.C. § 77q(a)(1970), which provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means . . . or by the use of the mails, . . . to employ any device, scheme, or artifice to defraud, or . . . to obtain money or property by means of any untrue statement of a material fact . . . or . . . to engage in any transaction, practice or course of business which operates or would operate as a fraud . . . .

A private right of action exists under this section. *See* Dyer v. Eastern Tr. & Banking Co., 336 F. Supp. 890 (D. Me. 1971); Pfeffer v. Cressaty, 223 F. Supp. 756 (S.D.N.Y. 1963).

7. 15 U.S.C. § 78j(b)(1970). This section provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . for the protection of investors.

Rule 10b-5, 17 C.F.R. § 240.10b-5 (1976) promulgated thereunder provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, . . . to make any untrue statement of a mate-

and sale of interests in their pension fund.

Daniel alleged that defendants had misrepresented the length and continuity requirements of the plan, and failed to disclose certain material facts concerning those requirements.[8] Additionally, he contended that as a result of these misrepresentations he acquired and subsequently maintained a "security" interest in the pension fund.[9] Contrary to his expectations, he did not receive any retirement benefits for the money paid into the pension fund on his behalf.[10]

Defendants moved to dismiss the complaint on various grounds. First, they contended that Congress viewed the federal securities laws as inapplicable to interests in pension funds since there is other legislation designed to deal with such interests.[11] Second, defendants argued that a stake in a pension plan is not a security and noted that the Securities and Exchange Commission (SEC) has consistently ruled that no sale of a security is involved in the operation of an involuntary, noncontributory employee pension fund.[12] Finally, defendants claimed that plaintiff's action was barred by the statute of limitations because he had admitted that the misrepre-

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rial 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 misleading, or . . . to engage in any act, practice, or course of business which operates or would operate as a fraud . . . in connection with the purchase of sale of any security.

8. 410 F. Supp at 546. A case decided after *Daniel* in the United States District Court for the Eastern District of Pennsylvania held that employees could not recover on the ground that the employer was unjustly enriched when their rights under a noncontributory, salaried pension plan were forfeited. The court did not mention *Daniel* or the federal securities laws. Hardy v. H.K. Porter Co. Inc., 417 F. Supp. 1175 (E.D. Pa. 1976).

9. 410 F. Supp. at 545-46.

10. *Id.* at 544-45. For a discussion of damages in a private action under the antifraud provisions of the federal securities laws, see Note, *Measurement of Damages in Private Actions Under Rule 10b-5*, 1968 WASH. U. L. Q. 165.

11. 410 F. Supp. at 547. The legislation referred to by the defendants is the Employees Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1381 (Supp. V, 1975).

12. 410 F. Supp. at 546. The SEC has taken the position that the offer or sale of certain types of voluntary, contributory plans are subject to the registration and prospectus requirements of the Securities Act. Although the SEC reserves opinion on a plan until a copy of it has been filed, the Commission's view is that no "offer" or "sale" under section 2(3) of the Securities Act is involved "in the case of noncontributory plan, . . . or in the case of a compulsory plan, where there is no element of volition on the part of employees whether or not to participate and make contributions." Opinion of Assistant General Counsel of Commission, [1941] 1 FED. SEC. L. REP. (CCH) ¶ 2105.53.

sentations began as early as 1955, and continued from that time.[13]

The district court in *Daniel v. International Brotherhood of Teamsters*[14] agreed with plaintiff that an investment in a pension fund constitutes the sale of a security as defined by the securities laws,[15] and that a private cause of action can be successfully litigated under the antifraud provisions of those laws.[16] The court conceded that the securities laws provide no explicit answer to whether involuntary and noncontributory pension plans involve the sale of a security,[17] but it found no statutory language prohibiting the application of these laws to pension funds.[18]

The term "security" is defined in the Securities Act as including "any . . . certificate of interest or participation in any profit sharing agreement . . . investment contract . . . or . . . any interest . . . commonly known as a 'security'."[19] Historically, the SEC has con-

13. 410 F. Supp. at 544. The issue involving the tolling of the statute of limitations requires the court to determine when plaintiff should have been aware of the misrepresentation in the plan (*i.e.*, when should a reasonable man have discovered the facts?). Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 788 (2d Cir. 1951).

In Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972), the Seventh Circuit held that the state blue-sky law's limiting period (three years) rather than the general statute of limitations for fraud (five years) should apply in a Rule 10b-5 action. *Id.* at 126. The court also noted that the law of Illinois, the forum state in *Parrent* and *Daniel*, gives the buyer of a security a right of rescission for conduct prohibited by the antifraud provisions. *Id.* at 125. ILL. REV. STAT. ch. 121 1/2 § 137.13 (Supp. 1977). *See also* Sperry v. Barggren, 523 F.2d 708 (7th Cir. 1975).

In Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967), the Sixth Circuit found that the six year statute of limitations for fraud was applicable because there was no state provision similar to that of Rule 10b-5.

14. 410 F. Supp. at 541.

15. *Id.* at 552-53.

16. *Id.* In addition to proving that the transaction involves the sale of a security, the federal securities laws require a plaintiff to establish a connection between his loss and the defendant's fraudulent conduct. For a plaintiff to have standing under Rule 10b-5 of the Exchange Act, he must be an actual purchaser or seller. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975). *Blue Chip* denied relief to offerees dissuaded from buying and stockholders persuaded to retain their stock. *Id.* at 754-55. In contrast, an employee who retains his job makes a decision which results in his continuing to give value for an increased interest in the pension plan.

In addition to meeting the test outlined in *Blue Chip*, a plaintiff in a Rule 10b-5 suit must prove scienter on the part of the defendant. Negligence alone will not suffice. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 197-99 (1976). For further discussion, see Foremost-McKesson, Inc., v. Provident Sec. Co., 423 U.S. 232, 249-51 nn.24 & 26 (1976).

17. 410 F. Supp. at 552.

18. *Id.* at 549. *But cf.* Weins v. International Bhd. of Teamsters, [1977] FED. SEC. L. REP. (CCH) ¶ 96,005 (C.D. Cal. March 28, 1977).

19. 15 U.S.C. § 77b(1)(1970). The definition of a security in the Exchange Act is substan-

cluded that Congress did not intend to bring involuntary and non-contributory pension funds within the ambit of the securities laws.[20] Moreover, agencies such as the Department of Labor have traditionally regulated the operation of pension funds.[21]

The Supreme Court first attempted to interpret the term "security" in *SEC v. C.M. Joiner Leasing Corp.*[22] Defendant oil promoter formed a corporation which acquired oil and gas leaseholds and then sold them to investors.[23] The lower court concluded that these acts did not involve the sale of a security, making the Securities Act inapplicable to the transactions.[24] The Supreme Court disagreed, concluding that the defendants were selling investment contracts.[25]

Rather than promulgating broad criteria for determining the presence of an investment contract, the *Joiner* Court confined its analysis to the facts of the case at bar.[26] But Mr. Justice Jackson, writing for the Court, cautioned that the "reach of the [Securities] Act does not stop with the obvious and the commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security"'."[27]

Three years later in *SEC v. W.J. Howey Co.*,[28] the Supreme Court again interpreted the terms "security" and "investment contract." Defendant Howey Company sold citrus grove plots to the public in order to acquire capital for additional development. The buyers were attracted to the groves by the expectation of substantial profits.[29] These buyers were generally out-of-state business and profes-

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tially the same. *Id.* § 78c(a)(10). For an analysis of the word "security," see Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367 (1967).

20. 410 F. Supp. at 546. *See also* note 12 *supra*.
21. 410 F. Supp. at 547.
22. 320 U.S. 344 (1943).
23. *Id.* at 346-48.
24. 133 F.2d 241 (5th Cir.), *rev'd*, 320 U.S. 344 (1943).
25. 320 U.S. at 351.
26. *Id.* at 355.
27. *Id.* at 351.
28. 328 U.S. 293 (1946).
29. *Id.* at 296.

sional people who lacked the knowledge, skill and equipment necessary for the care and cultivation of citrus trees. Defendant Howey-in-the-Hills Service Corporation, a subsidiary under the same management as defendant, serviced the groves under separate contracts. While the buyers were free to make arrangements with other service companies, defendant vigorously marketed the services of its subsidiary; and many executed service contracts with Howey-in-the-Hills.[30]

The Court found that these contracts, considered together, constituted an investment contract within the meaning of section 2(1) of the Securities Act.[31] Mr. Justice Murphy, speaking for the Court, stated that "an 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 . . . ."[32]

The most troublesome element of the *Howey* test is the requirement that profits come *solely* from the efforts of a promoter or third party.[33] Through a strict interpretation of this element, the Howey Company could have avoided the problems presented by the federal securities laws if it had asked the investors to pick one piece of fruit.[34] But Mr. Justice Murphy concluded the *Howey* opinion by stating that the "statutory policy for affording broad protection to investors is not to be thwarted by unrealistic and irrelevant formulae."[35] Moreover, several circuits have refused to read *Howey* so literally and have found that minimal investor participation will not prevent the application of the securities law.[36]

30. *Id.* at 294-96.

31. *Id.* at 300; 15 U.S.C. § 77b(1)(1970).

32. 328 U.S. at 298-99.

33. *Id.* at 299.

34. *Id. See* Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 Okla. L. Rev. 135, 140 (1971).

35. 328 U.S. at 301.

36. In SEC v. Glenn W. Turner Ent. Inc., 348 F. Supp. 766 (D. Ore. 1972), *aff'd*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973), the Ninth Circuit concluded that the investment contract concept is a flexible one. It disregarded the form of the transaction for its substance to find that defendant's "pyramid scheme" was an investment contract. 474 F.2d at 481. The scheme involved the payment of a fixed sum of money by the purchaser, in return for which he would attend classes aimed at improving his self-motivation and sales ability. After making several purchases, the investor was allowed to sell self-improvement courses to others. From their payments, he received a commission. *See* 348 F. Supp. at 775.

The Supreme Court continued to expand the scope of the Securities Act in *SEC v. Variable Annuity Life Insurance Co. of America (VALIC),*[37] where it concluded that variable annuities were subject to the registration provisions of the Securities Act.[38] The Court found a security to exist because a variable annuity places all of the investment risks on the annuitant, and none on the company.[39] It compared an annuity with an insurance contract where the company assumes all the investment risks, and stated that insurance contracts are not securities.[40] The Court found the Securities Act applicable even though such annuity schemes were concurrently subject to state regulation.[41]

In *Tcherepnin v. Knight,*[42] the Supreme Court held that holders of withdrawable capital shares[43] in an Illinois Savings and Loan Association were participants in a plan which involved the sale of a security under the Exchange Act.[44] Several purchasers of these shares brought a class action seeking rescission because of false and misleading statements made in the Savings and Loan Association's

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The Commission sought injunctive relief against defendant's pyramid scheme alleging that the investment was the sale of a security. The district court agreed, but cited no precedent. *Id.* at 773-76. The court of appeals adopted a controlling efforts analysis to show that the investors did not exercise managerial authority sufficient to affect the failure or success of the enterprise. 474 F.2d at 482. The specialized, high-powered tactics used by the promoters in the scheme indicated the existence of a security. *Id.* For a discussion of *Turner* and the court's analysis therein, see Note, *Pyramid Schemes: Dare to be Regulated,* 61 GEO. L. J. 1257, 1279 (1973). *See, e.g.*, Tenants Corp. v. Jakobson, 503 F.2d 1375 (2d Cir. 1974); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974); Lino v. City Investing Co. Inc., 487 F.2d 689 (3d Cir. 1973).

37. 359 U.S. 65 (1959).

38. *Id.* at 73.

39. *Id.* at 71-73.

40. *Id.* at 69, 73 (Brennan, J., concurring). *See also* SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967).

41. 359 U.S. at 69.

42. 389 U.S. 332 (1967).

43. Withdrawable capital shares are a method of raising capital which is authorized by Illinois statute. ILL. REV. STAT. ch. 32 § 761(a) (1970). A person becomes a holder of a withdrawable capital share after depositing money in an account at a savings and loan association. For each one hundred dollars of aggregate withdrawal value in the account, the investor is entitled to one voting share. There is no fixed rate of return, and dividends are declared by the board of directors based upon the association's profits. While withdrawable capital shares are non-negotiable, they can be transferred by written assignment accompanied by the appropriate certificate or account book. 389 U.S. at 337.

44. *Id.* at 338.

solicitation material.[45] That material portrayed the Association as a viable financial institution; however, it followed unsafe financial policies,[46] and was managed by individuals convicted of mail fraud. Defendants, because there was a sale of a security, were held liable under the antifraud provisions of the Exchange Act.[47] In *Tcherepnin,* as in *VALIC,* the Supreme Court found the federal securities laws applicable even though a state agency had concurrent jurisdiction.[48]

Recently, in *United Housing Foundation v. Forman,*[49] tenants of a low income housing cooperative alleged that defendant cooperative violated the antifraud provisions of the Securities Act and the Exchange Act by misrepresenting that future and substantial rent increases would be absorbed by the project developers.[50] The Court found that the tenants' "shares" in the cooperative were not securities.[51]

In *Forman,* the tenants had acquired an interest in a residential apartment for personal use rather than as an investment. The Court stated it would be difficult to conclude that the tenants were purchasing investment securities[52] where the interest acquired was a living accommodation.[53] Accordingly, the tenants' shares of stock lacked what was described as the most common feature of stock in *Tcherepnin, i.e.,* the right to receive "dividends contingent upon an apportionment of profits."[54] The Court also noted that the tenants' stock did not have other characteristics associated with securities, such as negotiability, voting rights in proportion to the number of shares owned, and the ability to appreciate in value.[55]

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45. *Id.* at 334.

46. There is no listing of the unsafe financial policies in the case, but because of these policies the Savings and Loan Association was denied federal insurance. *Id.*

47. 389 U.S. at 345.

48. *Id.* at 337-38.

49. 421 U.S. 837, *rehearing denied,* 423 U.S. 884 (1975).

50. 421 U.S. at 844.

51. *Id.* at 846-48.

52. *Id.* at 854. The deciding factor seems to be substance rather than form as the Court applied an "intent-revealed-in-context approach as against a literal-text-reading . . . ." C.N.S. Enterprises, Inc., v. G & G Enterprises, Inc., 508 F.2d 1354, 1356 (7th Cir. 1975).

53. 421 U.S. at 854.

54. 389 U.S. at 339.

55. 421 U.S. at 851. The Court also noted the absence of any indication that a return of capital would be forthcoming after the surrender of the premises. *Id.* at 854.

According to the Supreme Court, any investment which motivates investors to risk capital by a realistic expectation of profits can be a security.[56] The Court in *Howey, Joiner* and *Forman* looked at the economic realities underlying the transaction and not the name appended thereto in determining what constitutes a security.

The *Daniel* court agreed with the plaintiff's contention that his interest in the Local 705 Pension Fund was an investment contract within the meaning of the securities laws. In *Daniel,* money was invested in a common enterprise, management of the plan was committed to a third party and the participants in the plan expected profits in the form of retirement benefits.[57] Furthermore, the court found that the Local 705 trustees had the sole power of control over the common enterprise and the investment of all assets contained therein. Thus, the management of the investments was indeed committed to a third party.[58]

For the transaction in *Daniel* to be covered by the antifraud provisions of the federal securities laws, it was also necessary to find a sale of the security. Because the Securities Act defines a sale as "every . . . disposition of a security or interest in a security, for value,"[59] it was necessary for the *Daniel* court to determine whether the interests in the Local 705 plan were disposed of for value.[60]

The SEC has taken the position that the registration provisions of the Securities Act do not apply to transactions involving noncontributory, involuntary pension plans.[61] It has reasoned that employees involved in such plans receive their security interests as a gift and not for value; thus, there is no sale, nor is there any investment

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In the *Forman* dissent written by Mr. Justice Brennan, and joined by Mr. Justices Douglas and White, the view was posited that the tenants had invested money in the cooperative so that management would be as efficient as possible in its operations, the end result being reduced charges to the tenants. *Id.* at 861-62. This is probably the most liberal interpretation given to the word "security" by any member of the Court.

56. *Id.* at 854-55.

57. 410 F. Supp. at 550-52.

58. *Id.* at 551.

59. 15 U.S.C. § 77b(3)(1970). The definition of "sale" in the Exchange Act "include[s] any contract to sell or otherwise dispose of." *Id.* § 78c(a)(14).

60. 410 F. Supp. at 552-53.

61. Testimony of Commission Chairman Cohen when Congress was considering an amendment to exempt certain types of pensions from registration under the Securities Act. *Hearings on Amendment No. 435 to S. 1659 Before the Senate Comm. on Banking and Currency,* 90th Cong., 1st Sess., pt. 3, at 1326 (1967).

decision.[62] Because the purpose of the Securities Act is to disclose to prospective investors essential facts concerning the security to be purchased, those who receive a security as a gift would not benefit from the application of the Act.[63]

The *Daniel* court noted that employer pension plan contributions are recognized as part of an employee's wages.[64] It found that contributions of these wages constituted the employee's giving of value.[65] Economically, there is no difference between the facts in *Daniel* where the employer made the contribution directly to the fund, and the situation where an employee first receives the employer contribution as part of his wages and then pays it to the fund.[66] Moreover, the employee's services on the job can be viewed as consideration for the employer's contribution to the fund.

Daniel was not the first court to hold that the performance of services constitutes value, though it was the first court to do so with regard to a pension plan. In *Collins v. Rukin*,[67] defendant corporate president made an offer of employment to plaintiff. In additon to his salary, plaintiff was given the opportunity to participate in a stock purchase plan;[68] but instead of having to make cash payments for the stock, plaintiff could make his contribution in the form of services.[69] After accepting the offer of employment, plaintiff resigned and brought suit for a violation of the antifraud provisions

62. *Id.* The *Daniel* court disagreed with this position and concluded that employees participating in a pension fund do so on a voluntary basis. 410 F. Supp. at 553. It noted that the decision to accept or reject a wage package was a voluntary one because the employees could vote against an increased portion of their wages going towards the pension fund. *Id.*

63. 116 CONG. REC. 40608 (1970).

64. In support of its conclusion the court cited Inland Steel Co. v. N.L.R.B., 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949) where the Seventh Circuit Court of Appeals quoted a NLRB order which stated that the term wages in the National Labor Relations Act "must be construed to include emoluments of value, like pension and insurance benefits, which may accrue to employees out of their employment relationship . . . . Realistically viewed, this type of wage enhancement . . . becomes an integral part of the entire wage structure . . . ." 170 F.2d at 251. The Supreme Court followed the holding in *Inland Steel* twelve years later where it found employee contributions to a pension fund to be "really another form of compensation . . . ." Lewis v. Benedict Coal Corp., 361 U.S. 459, 469 (1960).

65. 410 F. Supp. at 552-53.

66. *Id.* at 553.

67. 342 F. Supp. 1282 (D. Mass. 1972).

68. *Id.* at 1284. The court said that a stock purchase plan could be considered a security. *Id.* at 1286-87.

69. *Id.* at 1289.

of the securities laws.[70] Defendant moved to dismiss the complaint stating that there was no sale of a security.[71] The United States District Court for the District of Massachusetts denied the motion, and found that the plaintiff's performance of services satisfied the value requirements of a sale.[72]

Although there have been decisions granting relief for the denial of pension benefits,[73] *Daniel* is the only case to conclude that membership in a pension fund involves the sale of a security. In recent "no-action" letters, the SEC staff has opined that employee stock plans involve a sale where there is an election by the employee to participate in the plan.[74] The Commission also has promulgated regulations defining a private retirement plan managed by a bank as a security, but only if there is an investment decision on the part of the participant.[75]

The courts have also looked to the element of volition in determining the existence of a sale under the securities laws.[76] In *Daniel,* the court found that bargained for employer contributions to the pension plan represented monies which could have been used for wages.[77] Thus, an investment decision was made as to the use of a portion of the wage package.

Although the securities laws provide an adequate remedy for fraudulent and manipulative acts in the sale of a security, defen-

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70. *Id.* at 1284-85.

71. *Id.* at 1285.

72. *Id.* at 1289-91. *See also* SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961). In *Addison* the court held that profit-sharing agreements between defendants and suppliers of services were investment contracts, and thus securities. The giving of certificates of interest in the profit-sharing agreement as consideration of services rendered constituted a sale. *Id.* at 722.

73. Meehan v. Laborers Pension Fund, 418 F. Supp. 29 (N.D. Ill. 1976); Lucas v. Seagrave Corp., 277 F. Supp. 338 (D. Minn. 1967).

74. Guaranty Corp., [1976] FED. SEC. L. REP. (CCH) ¶ 80,709 (October 8, 1976).

75. Independent Bankers' Ass'n, [1972-73 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,198 (January 8, 1973). In addition, former Chairman of the Commission Cohen testified that an employee acquiring an interest in a pension fund is making an investment decision to put into a fund "that which he would otherwise get in his paycheck." *Hearings Before the Subcommittee on Labor, Senate Comm. on Labor and Public Welfare,* 92d Cong., 2d Sess. 231 (1972).

76. Dasho v. Susquehanna Corp., 380 F.2d 262, 267 (7th Cir.), *cert. denied sub nom.* 389 U.S. 977 (1967); Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 202-03 (5th Cir. 1960), *cert. denied,* 365 U.S. 814 (1961); Inland Steel v. NLRB, 170 F.2d 247 (2d Cir. 1948), *cert. denied,* 336 U.S. 960 (1949); Collins v. Rukin, 342 F. Supp. 1282 (D. Mass. 1972).

77. 410 F. Supp. at 552-53.

dants in *Daniel* cited the enactment of the Employees Retirement Income Security Act (ERISA)[78] as indicating a congressional intent that the federal securities laws are inapplicable to pension plans. The court disagreed. It found that the intent of ERISA was to provide for the ongoing administration of pension plans and not the initial sale of the interest.[79] In *SEC v. Garfinkle*,[80] the United States District Court for the Southern District of New York reached a similar conclusion, holding that the enactment of ERISA was designed to complement rather than displace SEC authority.[81] In *Garfinkle*,[82] the court found a welfare fund director guilty of fraud when he arranged for the purchase of worthless or near worthless junior mortgages by his welfare fund.[83] The director received kickbacks for these arrangements, and because of their purchase the welfare fund suffered considerable financial losses.

The *Garfinkle* court held that the SEC is not divested of jurisdiction, even though the New York State Department of Insurance supervised and regulated the union welfare fund involved.[84] Nor, said the court, is the SEC precluded from acting because of the enactment of ERISA which gives the Secretary of Labor the power to regulate welfare funds.[85]

Prior to the passage of ERISA an employee or participant in a pension plan who was entitled to fair and equitable treatment may have been deprived of his earned benefits because his employer could terminate the benefit plan.[86] Some courts enforced the spirit of the benefit agreement, but large numbers of employees have lost their pensions because a court would not imply rights not expressly conferred by the plan itself.[87]

78. 29 U.S.C. §§ 1001-1381 (Supp. V, 1975) [hereinafter cited as ERISA].

79. 410 F. Supp. at 548. *See also* 29 U.S.C. § 1001(b)(Supp. V, 1975).

80. [1974-75 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,020 (S.D.N.Y. March 18, 1975).

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id. See* 29 U.S.C. § 1144(d)(Supp. V, 1975).

86. Schneider v. McKesson & Robbins, Inc., 254 F.2d 827 (2d Cir. 1958).

87. Local 2040, Machinists v. Servel Inc., 268 F.2d 692 (7th Cir.), *cert. denied*, 361 U.S. 884 (1959); Gorr v. Consolidated Foods Corp., 253 Minn. 375, 91 N.W.2d 772 (1958). *See generally* Bernstein, *Employee Pension Rights When Plants Shut Down: Problems and Some Proposals*, 76 HARV. L. REV. 952 (1963).

Following a comprehensive study, Congress concluded that federal statutes which purported to control the area of pension fund reporting and disclosure were inadequate.[88] The Internal Revenue Service had the power to grant or disallow tax exemptions to plans,[89] but this supervision provided only limited control over benefits.

The Welfare and Pension Plans Disclosure Act (WPPDA),[90] the predecessor of ERISA, proved inadequate because it contained no enforcement powers.[91] In additon, WPPDA lacked fiduciary standards and placed upon the participant the duty to monitor his plan. The Labor-Management Relations Act (LMRA)[92] provided protection for employees in plans administered jointly by employers and unions.[93] It imposed penalties for the fraudulent structure of trusts and required that the plan be for the "sole and exclusive benefit of [the] employee . . . ."[94] But the LMRA did not provide for vesting standards, funding adequacy, nor sufficient standards of fiduciary conduct.[95]

ERISA established standards for vesting,[96] funding adequacy,[97] portability of credits earned at other jobs,[98] and standards of fiduciary conduct.[99] Also, ERISA now requires insurance to provide financial soundness to a plan.[100]

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88. SENATE COMM. ON LABOR AND PUBLIC WELFARE, INTERIM REPORT OF ACTIVITIES OF THE PRIVATE WELFARE AND PENSION PLAN STUDY, S. REP. NO. 634, 92d Cong., 2d Sess. 74-75 (1972).

89. I.R.C. § 401.

90. 29 U.S.C. §§ 301-09 (1970), *repealed by* 29 U.S.C. § 1031 (Supp. V, 1975) [hereinafter cited as WPPDA].

91. *See* note 87 *supra*.

92. 29 U.S.C. §§ 141-88 (1970) [hereinafter cited as LMRA].

93. *Id.*

94. Insley v. Joyce, 330 F. Supp. 1228, 1232 (N.D. Ill. 1971).

95. *Id.* at 1231.

96. ERISA provides that the employer may choose from three alternative plans. 29 U.S.C. § 1053(a)(2)(Supp. V, 1975). First, credits accrue to the employee, and after ten years of service his rights are fully vested. *Id.* § 1053(a)(2)(A). Second, 25 percent of an employee's rights vest after five years of service. In the next five years his rights vest 5 percent each year, and in the following five years his rights vest 10 percent each year. After fifteen years, he is fully vested. *Id.* § 1053(a)(2)(B). Third, the employee is 50 percent vested when the sum of his age and years of service equal forty-five, providing he has at least five years of service. *Id.* § 1053(a)(2)(C)(i). In the next ten years his rights vest in increments of 10 percent every other year. *Id.* § 1053(a)(2)(C)(ii). When the sum of his age and years of service equal fifty-five, he is fully vested. *Id.* § 1053(a)(2)(C)(i).

97. *Id.* §§ 1081-86.

98. *Id.* §§ 1051-61.

99. *Id.* §§ 1101-14.

100. *Id.* § 1323.

ERISA is important in cases such as *Daniel* because of the need for proper disclosure of the contents of a pension plan. The duty of fair disclosure and reporting under ERISA entitles those who have joined a pension plan to receive an annual report and plan description. In addition, the participant is entitled to a statement of his accrued benefits and earned non-forfeitable rights. Disclosure, under ERISA, is a means of communicating sufficient information to participants to enable them to make intelligent decisions based on this information.[101] Nevertheless, as the *Daniel* court held, "Congress has not demonstrated . . . any intent to make securities laws inapplicable to employee pension funds."[102]

Employee pension plans play a significant if not determinative role in the employee's decision whether to take or maintain a job. When an employee is induced by fraudulent and material misrepresentations to enter into and maintain his position in a pension plan by continual payments, a denial of his right of recovery under established theories of securities law would be in contravention of equitable principles.

Courts have recognized that the sale of a security takes place when there is an investment of value. No longer does the form of the investment play a determinative role, because courts now look to the underlying economic realities.

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101. *Id.* § 1001(b).
102. 410 F. Supp. at 549.