Toward the Equitable Establishment and Administration of Pension Plans: Teaming ERISA with the Securities Laws

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Toward the Equitable Establishment and Administration of Pension Plans: Teaming ERISA with the Securities Laws

In Daniel v. International Brotherhood of Teamsters the Seventh Circuit held that federal antifraud securities legislation protects an employee’s interest in a noncontributory, compulsory pension plan. The court found the “sale” of a “security” where an employee voted to accept a collectively bargained labor agreement embodying the pension plan, and thereby recognized his right of action under the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act) for alleged fraud in connection therewith.

This article will (1) evaluate the application of the 1933 and 1934 Acts in the context of a noncontributory, compulsory pension plan; (2) demonstrate that the Securities and Exchange Commission’s (SEC) “no sale” theory as formerly applied to such pension plans was unrealistic and resulted in inconsistent enforcement of the securities laws; and (3) discuss the impact of eliminating the no sale theory and the application of the antifraud provisions of the 1933 and 1934 Acts on pension fund trustees, employers and participants. Further, this article will examine the enforcement provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and demonstrate that ERISA provides inadequate protection to participants in pension plans. When ERISA is supplemented by the antifraud provisions of the 1933 and 1934 Acts, however, the...
being or about to become a director, person performing similar functions, or partner;
(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;
(5) every underwriter with respect to such security.

15 U.S.C. § 77k (1976). Section 12 of the 1933 Act provides:
Any person who—
(1) offers or sells a security in violation of section 77e of this title, or
(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary to make the statements, in light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

15 U.S.C. § 77l (1976). Section 17 of the 1933 Act provides in pertinent part:
(a) 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 communication in interstate commerce or by the use of the mails, directly or indirectly—
(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 omission to state a material fact necessary in order to make the statements made, in 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.

(c) The exemptions provided in section 77c of this title shall not apply to the provisions of this section.

15 U.S.C. § 77q (1976). Rule 10b-5, promulgated pursuant to section 10(b) (15 U.S.C. § 77j(b)) of the 1934 Act, 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,
(1) To employ any device, scheme, or artifice to defraud, or
(2) To make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, or
(3) 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.

participant in a noncontributory, compulsory pension plan is afforded a full recovery from the fraudulent acts of either pension fund administrators or trustees.

THE BREADTH OF THE SECURITIES LAWS

Transactions involving securities are subject to regulation on both state and federal levels. The federal securities laws, enacted to protect investors in a previously unregulated market, apply to all securities transactions which involve the use of interstate commerce and which are not expressly exempt.

In defining "security," courts have been guided by two principles which form the basis of interpretation of the 1933 and 1934 Acts. Both Acts were designed to assure that investors are provided with full and fair disclosure of material information concerning securities and their issuers, to protect investors from fraud, and to promote ethical standards of honesty and fair dealing through the imposition of criminal and civil sanctions. Second, to effectuate the Acts' remedial purposes, "form should be disregarded for substance and the emphasis should be on economic reality." In addition, the Supreme Court has held that the definition of "security" should be flexible and capable of adaptation in order to meet the countless number of schemes the securities laws are intended to regulate. In practice, this has led to the application of the 1933 and 1934 Acts to transactions which are fundamentally different from transfers of stock on national securities exchanges. For example, courts have held that shares or interests in self-improvement courses, beaver farms, whiskey sales contracts, pyramid sales schemes and min-

11. See, e.g., Securities Act of 1933, §§ 3 (exempting certain securities), 4 (exempting certain transactions), 15 U.S.C. §§ 77c, 77d (1976); but see note 8 infra, for the proposition that the antifraud provisions may nevertheless apply.
eral leases are "securities" subject to regulation under the 1933 or 1934 Act.

A Definition of "Security"

Section 2(1) of the 1933 Act provides in pertinent part: "(1) The term 'security' means any note, stock, . . . certificate of interest in any profit-sharing agreement, . . . investment contract, . . . or, in general, any interest or instrument commonly known as a 'security'. . . ." Section 3(a)(10) of the 1934 Act provides a similar definition. Despite some differences in the terminology of the 1933 and 1934 Acts, courts have held that the tests applied under each Act in determining what is a security are identical.

In SEC v. W.J. Howey Co., the defendant offered public investors units of a citrus grove development coupled with a contract for cultivating and marketing the harvest and remitting the net proceeds of sales of the fruit to the investor. The United States Supreme Court held that the interest so offered was an "investment contract," defining that term as 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. . . ." The requirement that profits be expected "solely" from the efforts of others was relaxed in the subsequent decision of United Housing Foundation, Inc. v. Forman. In Forman the Court held that profits need only be derived from the entrepreneurial or managerial efforts of others. Combining the Howey test with the Forman modification, the investment contract test for determining what is a security subject to federal regulation may be stated as a

18. Penfield Co. of Cal. v. SEC, 143 F.2d 746 (9th Cir. 1944).
22. Section 3(a)(10) of the 1934 Act provides that the term security shall not include "currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity date at the time of issuance of not exceeding nine months. . . ." Securities Exchange Act of 1934, § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976).
25. Id. at 298, 299.
27. Id. at 852.
28. The interests which plaintiffs in Forman claimed were securities were interests in a state-subsidized cooperative apartment corporation which were purchased as an incident of tenancy. The Court held that the purchasers of such interests did not have an expectation of profits; they purchased the shares to live in the apartment complex. Id. at 854. In addition, because the shares were purchased as an incident of tenancy, intent to invest was not apparent. Id.
scheme whereby a person *invests money* in a *common enterprise* and is led to *expect profits* utilizing the managerial *efforts of others*. In *Daniel v. International Brotherhood of Teamsters*,²⁹ the plaintiff was covered by a noncontributory, compulsory pension plan for over twenty-two years, the only interruption in his service being a five month involuntary layoff.³⁰ He alleged, *inter alia*, that defendants failed to inform him when he accepted an interest in the pension plan that a “break-in-service” would result in the forfeiture of all non-vested rights he had acquired based on the contributions made on his behalf and the earnings accumulated thereon.³¹ Plaintiff Daniel did not learn of his ineligibility for pension benefits until he retired at age sixty-three. Prior to that time, numerous discussions with union officials had led him to believe he would receive $400 monthly upon his impending retirement.³²

In order for plaintiff to assert a cause of action under the federal securities laws, the court had to find preliminarily that an interest in the pension plan was an investment contract.³³ The court applied the modified *Howey* test to the interest in the pension plan and found a common enterprise, likening the pension fund to a mutual fund whose money is invested in capital markets and whose shares are not evidenced by certificates and are not alienable.³⁴ The court reasoned that the employer contributions actually were compensation to the employee and that the pension fund trustees exercised exclusive control over the common enterprise of collecting such contributions and making investments.³⁵ Thus three aspects of the modified *Howey* test were met: (1) an investment; (2) in a common enterprise; (3) managed by others. The court found the fourth and final aspect of the test, the expectation of profits, satisfied where the expected pension benefits exceeded the employer’s contributions made on the employee’s behalf.³⁶

The requirement of an expectation of profits proved to be the most difficult prong of the *Howey* test for the plaintiff to meet. The court stated that the actuarial probability of receiving benefits under the pension plan was eight percent due to such factors as risk

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³⁰. *Id.* at 1227.
³¹. *Id.* at 1226-27.
³². *Id.* at 1228.
³³. *Id.* at 1230; the Seventh Circuit adopted much of the rationale of Judge Kirkland in the district court (410 F. Supp. 541 (N.D. Ill. 1976)).
³⁴. 561 F.2d at 1233, 1236.
³⁵. *Id.* at 1233-34.
³⁶. *Id.*
of loss, breaks-in-service, plan termination and death before retirement.\textsuperscript{37} It may seem as though no participant had a legitimate expectation of receiving benefits, let alone profits. Moreover, the reasonableness of the presumption that benefits will exceed contributions is suspect given the possibilities that the employee may cease employment prior to the date that pension benefits vest, or that the employee may die subsequent to retirement but prior to receiving in pension and death benefits the amount contributed on his behalf.\textsuperscript{38} Nevertheless, pension fund trustees invest contributions in capital markets with the expectation of earning profits, thereby increasing the corpus of the fund; the defendants conceded this gain to be at least twenty-five percent.\textsuperscript{39} This is an indication that even after administrative expenses are paid, the participant can expect more in benefits than was contributed into the fund. Furthermore, the promise of benefits in excess of contributions is an inducement to the employee to participate in the pension plan.

The difference between contributions and benefits may not closely resemble the profit derived from most securities or stocks. However, because the federal securities laws are to be liberally construed for the protection of investors, the concept of profit similarly should be liberally construed. The profit Daniel expected was as real, though speculative, as that expected by the investors in W.J. Howey Co. who contributed money to a citrus grower for an interest in the proceeds of the sale of his harvest. The presence of a profit motive was not derogated by the speculative nature of the investment. Thus, the court found that Daniel satisfied the burden of showing he had a reasonable expectation of profiting from his investment, particularly where he previously refused employment by employers not participating in the pension plan and had himself participated in the plan for nearly twenty-three years.\textsuperscript{40}

Courts considering the issue prior to Daniel generally held that federal securities laws did not encompass noncontributory pension plans. These decisions, however, find little support in labor or securities law principles. In \textit{Weins v. International Brotherhood of Teamsters},\textsuperscript{41} for example, an action was brought under the federal securities laws for fraud involving a noncontributory pension plan. A federal district court in California, relying solely on the definition

\begin{itemize}
\item \textsuperscript{37} Id. at 1228-29.
\item \textsuperscript{38} Loss, Daniel v. International Brotherhood of Teamsters—A Report to the Committee on Federal Regulation of Securities From the Study Group of the 1933 Act, 32 Bus. Law. 1925, 1936 (1977).
\item \textsuperscript{39} 561 F.2d at 1234.
\item \textsuperscript{40} Id. at 1231, 1234-35.
\end{itemize}
of "stock" found in Forman, held that because an interest in a pension plan does not confer the right to receive dividends or voting rights in the percentage of "shares" owned, is not negotiable, cannot be pledged or hypothecated and does not appreciate in value, an interest in the pension plan is not a security.\textsuperscript{42} The court ignored the Supreme Court's mandate that the emphasis should be on economic reality\textsuperscript{43} and did not consider precedent in which other courts found securities in the form of investment contracts in schemes in which an investment decision and expectation of profits much less apparent.\textsuperscript{44}

In Robinson v. United Mine Workers,\textsuperscript{45} an interest in a noncontributory, compulsory health and retirement benefit plan was held not to be a security. The court reasoned that the beneficiaries made no investment in the plan.\textsuperscript{46} Robinson is distinguishable from Daniel in that contributions were made by the coal mining company based on the amount of coal mined, not on the basis of the number of employees or employee-hours worked.\textsuperscript{47} Thus, there was only a tenuous connection between employer contributions (the investment) and the employee; the contributions could not be characterized as investments in the form of foregone or deferred wages.\textsuperscript{48}

Daniel and the above cases reflect a divergence of opinion concerning the nature of interests in pension plans and their relation to the securities laws due to the "no sale" theory and the elastic definition of security.

The Definition of "Sale": Toward the Elimination of the "No Sale" Theory

The antifraud provisions of the 1933 and 1934 Acts apply to "sales" of securities.\textsuperscript{49} Section 2(3) of the 1933 Act defines sale to

\begin{itemize}
\item \textsuperscript{42} Id.
\item \textsuperscript{43} See note 13 supra.
\item \textsuperscript{44} See notes 16-20 supra and accompanying text.
\item \textsuperscript{45} 435 F. Supp. 245 (C.D. Cal. 1976).
\item \textsuperscript{46} Id. at 247.
\item \textsuperscript{47} Id.
\item \textsuperscript{48} See notes 68 and 72 infra and accompanying text. The same federal district court, in Hum v. Retirement Trust Fund, 424 F. Supp. 80 (C.D. Cal. 1976), held that an interest in a pension plan was not a security obtained in a sale. Id. at 81. The court, in a cryptic opinion, did not state whether the plan was compulsory or voluntary, contributory or noncontributory. In addition, the court incorrectly stated that ERISA specifically pre-empts the application of the federal securities laws to pension plans. Id. at 82.
\item \textsuperscript{49} See note 8 supra.
\end{itemize}
include every "disposition of a security or interest in a security for value." Section 3(a)(14) of the 1934 Act defines sale to include "any contract to sell or otherwise dispose of." Courts have interpreted sections 2(3) and 3(a)(14) identically, deeming sale a comprehensive term not to be narrowly construed. Prior to Daniel, both the SEC and the courts distinguished pension plans on two levels. First, with respect to compulsory versus voluntary plans, the SEC reasoned that no sale or investment decision was made where an employee was required to accept a compulsory plan as a condition of employment. The employee chose to accept the job, not the pension plan. Second, with respect to noncontributory versus contributory plans, the SEC and the courts believed that the acceptance of a noncontributory plan did not constitute a sale or investment decision because no value flowed from the employee to the fund. The employer's contribution was deemed a gift. These distinctions resulted in curious inconsistencies in the application of the securities laws to pension plans.

The legislative history of the 1933 Act does not conclusively resolve these inconsistencies but indicates that the Act was intended to regulate some pension plans. In 1934, the Senate proposed an amendment to exempt from registration: (1) any offering made solely to employees of an issuer or its affiliates in connection with a bona fide plan for the payment of extra compensation; or (2) a stock investment plan for the exclusive benefit of such employees. The fact that Congress expressed the need to exempt certain plans indicates that some plans were in fact subject to the requirements of the 1933 Act. The amendment was eliminated in a joint conference committee with the House on the ground that the participants in

52. Lawrence v. SEC, 398 F.2d 276 (1st Cir. 1968).
56. See note 64 infra and accompanying text.
58. See notes 64-66 infra and accompanying text.
employee stock investment plans may need the protection afforded by the availability of information concerning the issuer for which they work as much as most members of the public.\textsuperscript{60}

However, SEC Commissioner Purcell testified in 1941 that participants in a compulsory plan do not need the protection of registration because participation in the plan is a condition of employment; thus, no volition or sale is involved.\textsuperscript{61} He reasoned that the purpose of the registration process is to disclose to prospective investors the essential facts about the securities they are asked to purchase.\textsuperscript{62} The Commissioner saw no point in registration where employees are given no choice as to whether to buy.\textsuperscript{63} He acknowledged the need but refused to sanction the securities laws as the vehicle for the protection of participants in certain pension plans.

This paradoxical situation is a product of the SEC’s no sale theory which holds that no sale is involved in the case of a noncontributory plan where employees are not required to make contributions, or in the case of a compulsory plan where there is no element of volition on the part of the employee whether to participate.\textsuperscript{64} The requirement of this type of volitional investment decision is unrealistic as applied to pension plans. Whether contributory or noncontributory, funding of the pension plan is made in return for the services of the employee. Courts and the SEC have never demanded so strict a “volitional requirement” as mandating an investor-employee to invest his own currency in return for a security. The SEC has often departed from a strict application of the no sale theory. First, the SEC opined that a proposed gift of a company’s unregistered securities to thirty-five employees whose compensation had been reduced was actually a sale of securities which therefore had to be registered.\textsuperscript{65} Second, the SEC has stated that the redistribution of shares of a corporation’s issued and outstanding stock—which it would purchase over the counter—as prizes to representative and distributor organizations or their employees to induce them to generate more sales, constituted the sale of such securities.\textsuperscript{66} Furthermore, the SEC informed a corporation which had a policy of paying cash bonuses to key employees that the offer of stock in lieu of a cash

\textsuperscript{60} H.R. Rep. No. 1838, 73d Cong., 2d Sess. 41 (1934).
\textsuperscript{61} 1941 Hearings, supra note 59, at 896-97.
\textsuperscript{62} Id.
\textsuperscript{63} Id.
\textsuperscript{64} 1 Fed. Sec. L. Rep. (CCH) ¶ 2105.53 (1975).
bonus would constitute a sale. Analogizing to the pension situation, when employees choose to accept an interest in a pension plan in lieu of additional monetary compensation, they voluntarily choose to invest their foregone wages, i.e., to purchase a security. The SEC adopted this rationale in Daniel.

The no sale theory attempts to justify the distinction between a labor contract providing for monetary wages to be paid the employee who in turn contributes to the fund, and one providing for less monetary wages to be paid the employee because the employer contributes to the fund. The net compensation in both instances is the same. The elimination of the no sale theory in this context will promote similar treatment of pension plans regardless of the mechanics of funding and will effectuate the purpose of the securities laws. Court decisions and expressions of congressional intent reject the theory that employer contributions are gifts and adopt the view that they are foregone wages or indirect compensation. Interests in pension plans are therefore subject to collective bargaining. The impact of this change in philosophy is that courts recognize that the employee's services constitute valuable consideration exchanged for an interest in the pension plan, undermining the premise of the no sale theory.

The distinction between voluntary and compulsory pension plans is likewise unrealistic. So long as the employee's interest is obtained through a contribution of a portion of his services or wages—an undoubtedly conscious, voluntary decision on his part—the fact that his participation is a compulsory incident of employment does not derogate his volitional judgment to work and to invest a portion of his compensation in the pension fund. Former SEC Commissioner Cohen apparently agreed when he stated that an employee who acquires an interest in a pension plan makes an investment decision when he elects to place in the pension fund "that which he would otherwise get in his paycheck."

In Daniel, the Seventh Circuit reasoned that to the extent an

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68. Collins v. Rukin, 342 F. Supp. 1282 (D. Mass. 1972) (an exchange of services for stock is a sale for value); SEC v. Addison, 194 F. Supp. 709 (N.D. Tex. 1961) (a profit-sharing agreement between defendant and suppliers is an investment contract and therefore the exchange of services for an interest in the investment contract is a sale).
employee contributes his services in return for his employer’s contribution to the pension fund, he makes an investment decision, and thereby gives value for an interest in the plan by deferring a portion of his compensation. Since the purpose of the securities laws is to provide full and fair disclosure of material information and remedies for unlawful activity, the court’s finding is well-reasoned.

**THE IMPACT OF DANIEL**

The issue in *Daniel* was limited to whether the antifraud provisions of the 1933 and 1934 Acts applied to the Local 705 Pension Trust Fund. The court, by affirming the denial of a motion to dismiss, held that the antifraud provisions afford a union member a cause of action based upon fraud in connection with the establishment or administration of a noncontributory, compulsory pension plan.

It has been suggested that deeming an interest in a noncontributory, compulsory pension plan a security subject to regulation under the federal securities laws will lead to the termination of existing plans and will deter the establishment of new plans. Such Draconian predictions are based upon the belief that employers will be discouraged from adopting pension plans due to their fear of liability for fraudulent activity and their reluctance to incur the added costs of full disclosure. Any employer who contemplates fraudulent activity should be deterred from establishing a pension plan. A legitimate reason for the application of the securities laws is to deter fraudulent activity in connection with the sale of securities. In addition, the costs of providing full and fair disclosure are not avoided by refusing to apply the securities laws. ERISA mandates disclosure and periodic reporting of information so that regardless of whether the 1933 and 1934 Acts apply, an employer nevertheless will have to incur the cost of disclosure.

The impact of *Daniel* on pension fund administrators and trustees is multifarious. First, pension fund administrators and trustees must make full and fair disclosure of all material facts to participants in pension plans. Material facts are those which a reasonable

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72. 561 F.2d at 1243.
73. See note 12 supra and accompanying text.
74. See note 8 supra.
75. 561 F.2d at 1227.
76. Id. at 1251. The court expressed no opinion as to whether the registration requirements of the Acts applied.
78. Id. at 370.
prospective participant "might"\textsuperscript{80} consider important in making his decision to accept either the job or labor agreement which involves a pension plan. In Daniel, the pension fund trustees allegedly failed to explain to the plaintiff that he would be eligible for pension benefits only if he amassed twenty uninterrupted years of employment. This omission was held to be a proper basis for a cause of action for fraud in connection with the sale of a security.\textsuperscript{81} Second, pension fund administrators and trustees must not make misleading statements concerning the plan to prospective participants. Violation of either of these first two requirements may result in liability under the 1933 or 1934 Act.\textsuperscript{82}

Third, pension fund trustees must refrain from mismanagement of the assets of the fund because corporate mismanagement may be actionable under the federal securities laws. For example, in Superintendent of Insurance v. Banker's Life and Casualty Co.,\textsuperscript{83} the Supreme Court held that mismanagement of the proceeds of the sale of securities is actionable under rule 10b-5. Although ERISA sets minimum standards of fiduciary conduct,\textsuperscript{84} participants in the plan are not provided a direct recovery from possible fraudulent activity. In addition, ERISA allows fund trustees to be participants in the pension plan\textsuperscript{85} and details certain prohibited transactions\textsuperscript{86} but, unlike the federal securities laws, does not authorize a participant whose interest is adversely affected to recover from the mismanagement of self-dealing of the trustee.\textsuperscript{87}

Fourth, if the plan administrators propose an alteration or termination of benefits, the participant whose interest is adversely affected may be able to recover under the federal securities laws, while his recovery under ERISA would be negligible or non-existent. The absence of a valid business purpose for the proposed alteration or termination of benefits may result in liability under rule 10b-5. Although the Supreme Court generally prefers resort to state remedies for such wrongs, in Popkin v. Bishop,\textsuperscript{88} the Second Circuit held that if a proposed merger is subject to shareholder approval, full and fair disclosure is required;\textsuperscript{89} if no shareholder vote is required, the

\textsuperscript{81} 561 F.2d at 1226.
\textsuperscript{82} See note 8 supra.
\textsuperscript{83} 404 U.S. 6 (1971) (seller of bonds duped into believing it would receive the proceeds of the sale thereof).
\textsuperscript{84} 29 U.S.C. § 1104 (Supp. IV 1974).
\textsuperscript{85} Id. § 1108(c).
\textsuperscript{86} Id. § 1106.
\textsuperscript{87} See notes 8 supra and 117-18 infra.
\textsuperscript{88} 464 F.2d 714 (2d Cir. 1972).
\textsuperscript{89} Id. at 720.
court will look to the fairness of the terms of the merger and whether deception is involved.\textsuperscript{99} Similarly, \textit{Marshel v. AFW Fabrics Corporation}\textsuperscript{91} held that where no valid business purpose was stated for a proposed merger a violation of rule 10b-5 resulted.\textsuperscript{92} In the context of a pension plan, if the plan administrators propose an alteration or termination of benefits, the participant whose interest is adversely affected may recover under the federal securities laws. For example, where plan administrators proposed a reduction in benefits, perhaps in exchange for additional monetary compensation, and where the legal requirements for amendment of the plan were followed, a participant who objects to the amendment may have no recourse absent the application of the federal securities laws. Such a participant could not enjoy the rights conferred by the 1933 and 1934 Acts upon shareholders dissatisfied with a fundamental change in the character of their securities or the issuer. Under ERISA, his recovery may be negligible or non-existent for he is entitled only to benefits due him under the terms of his amended plan.

In addition to the possible liability of pension fund trustees and administrators, an employer who is not acting as trustee, may be liable as an aider or abettor\textsuperscript{93} of fraud perpetrated upon the participant. Thus, employers have a duty to refrain from withholding or misstating material information.\textsuperscript{94} Moreover, if the employer has knowledge of an omission or misstatement of a material fact by the pension fund trustees or administrators, the employer has an affirmative duty to disclose or correct the material information.\textsuperscript{95}

\textbf{A Justification of the Application of the 1933 and 1934 Acts to Pension Plans}

It is apparent, therefore, that the extent of liability under the

\textsuperscript{90} Id. at 719.
\textsuperscript{91} 533 F.2d 1277 (2d Cir.), vacated on other grounds, 429 U.S. 881 (1976), declared moot 552 F.2d 471 (1977).
\textsuperscript{92} Id. at 1281; \textit{but cf.} Santa Fe Industries v. Green, 97 S. Ct. 1292 (1977) (that a short form merger authorized by and complying with state corporation law which did not require a corporate purpose by the merger did not violate rule 10b-5).
\textsuperscript{93} \textit{See} Ernst and Ernst v. Hochfelder, 425 U.S. 185 (1976).
\textsuperscript{94} \textit{See note 8 supra; see also In re Caesar’s Palace Sec. Litigation}, 360 F. Supp. 366 (S.D.N.Y. 1973).
\textsuperscript{95} \textit{But if such employer input takes the form of discussions with employees concerning their vote on a collectively bargained agreement, the employer may be engaged in conduct violative of the National Labor Relations Act, 29 U.S.C. § 158(a)(2) (1970), and the entire collectively bargained agreement may be void. Mon River Towing, Inc. v. NLRB, 421 F.2d 1 (3d Cir. 1969); NLRB v. General Electric Co., 418 F.2d 736 (2d Cir. 1969), cert. denied, 397 U.S. 965 (1970). This potential conflict can be avoided by having the employer input take any form other than participation in union meetings on contract ratification.}
federal securities laws differs from that under ERISA. An explanation for this and a justification for their joint application can be found in the fundamental difference in the purposes behind the Acts. ERISA was designed to establish minimum standards of fiduciary conduct for trustees and administrators of pension plans, to provide for the enforcement of those standards through criminal and civil sanctions, to require the disclosure of the plan’s administrative and financial affairs, to improve the financial soundness of pension plans by requiring them to maintain minimum vesting standards, and to guarantee the adequacy of the fund assets against the risk of the termination of the plan prior to the completion of the normal funding cycle by insuring the unfunded portions of vested benefits. ERISA was aimed at the ongoing administration of pension plans as opposed to the regulation of issuers and securities prior to their sale, with which the federal securities laws are primarily concerned. This difference in perspective is reflected in the different requirements and remedies of ERISA and the 1933 and 1934 Acts.

Both the federal securities laws and ERISA mandate the initial filing of information and disclosure of information in periodic reports, and provide sanctions. However, they differ as to the extent and timing of disclosure and as to the remedies available for violations. It has been suggested that the disclosure requirements of ERISA are not sufficiently comprehensive so as to afford the same degree of protection as is available under the federal securities laws. The 1933 Act requires disclosure, prior to the sale of a security, of all material information which a reasonable investor might consider important in making his investment decision. The Act does not limit the extent of such disclosure, that determination being made on a case by case basis. On the other hand, ERISA requires the disclosure only of certain information which would ‘reasonably apprise . . . beneficiaries of their rights and obligations

101. See notes 8 supra and 117 & 118 infra.
107. Id. § 77g (all material information must be disclosed).
under the plan, such as eligibility requirements, details of the collective bargaining agreement, circumstances under which benefits vest or forfeit, and claims procedures. However, ERISA compels disclosure only within ninety days of the participant's entry into the plan. If an interest in any pension plan is deemed a security obtained in a sale, the purchaser of such interest should be afforded the protection of the federal securities laws prior to his entry into the plan. The information about the plan and its administration may affect his investment decision.

However similar ERISA and the 1933 and 1934 Acts may be with respect to their jurisdictional requirements and criminal sanctions, the civil recovery under ERISA is significantly narrower, allowing the recovery of wrongfully withheld benefits or of a small penalty from the administrator for withholding information. The 1933 and 1934 Acts provide sanctions against those who sign a materially misleading registration statement or use a materially misleading prospectus, and any person (and those who aid or abet such person) who omits or misstates a material fact in connection with the offer, purchase or sale of a security.

Section 501 of ERISA imposes criminal liability on persons who willfully violate the disclosure or reporting requirements. Section 502 of ERISA provides a civil recovery to a participant damaged by the pension fund trustees' non-compliance with the Act. However,
the efficacy of these sanctions is limited in at least four respects. First, ERISA took effect on January 1, 1975. If the fraudulent acts of which the participant complains took place prior to that date, liability will not ensue under ERISA. Absent the application of the antifraud provisions of the 1933 and 1934 Acts, employees so defrauded may have no statutory remedy. Second, criminal penalties do not provide compensation to a defrauded participant. An employee deceived into a false sense of security, believing he is entitled to pension benefits, is not made secure by knowing that the defrauder has been jailed or fined.

Third, the civil sanctions of ERISA are prospective, authorizing declaratory and injunctive relief. Retrospective relief in the form of money damages is available only where benefits or information have been wrongfully withheld. A recovery under section 502(a)(1)(B) is limited to “amounts due [the participant] under the terms of his plan.” If an employee is led to expect benefits when in fact he is entitled to none, this section affords him no redress, for no “benefits are due to him under the terms of his plan.” The only remedy under ERISA for this participant is a declaratory judgment clarifying his rights under the plan.

On the other hand, because the participant was defrauded in connection with the sale of a security, the antifraud provisions of the 1933 and 1934 Acts would afford him a recovery regardless of his eligibility for pension benefits. Sections 11 and 12 of the 1933 Act, which allow damages or rescission, apparently would apply in the context of a pension plan just as against any other issuer of securities if misleading statements or omissions were contained in a registration filing.

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violates any provision of this subchapter or the terms of the plan, or (B) to obtain other appropriate equitable relief . . .

(c) Any administrator who fails or refuses to comply with a request for any information which such administrator is required by this subchapter to furnish to a participant or beneficiary (unless such failure or refusal results from matters reasonably beyond the control of the administrator) by mailing the material requested to the last known address of the requesting participant or beneficiary within thirty days after such request may in the court’s discretion be personally liable to such participant or beneficiary in the amount of up to $100 a day from the date of such failure or refusal, and the court may in its discretion order such other relief as it deems proper.


119. Id. §§ 1132(a)(1)(B), 1132(a)(3)(A).

120. Id. § 1132(a)(1)(B).

121. Id.

122. Id.

123. Id.


125. Id. § 77l.
Thus, a participant who seeks recovery under section 11 for a materially misleading registration statement may receive the difference in value between the benefits promised and the benefits due. A participant who seeks recovery under section 12 for misleading statements or omissions may rescind the sale and receive the consideration he or his employer has transferred to the fund, plus interest. These amounts may be considerably greater than "amounts due to him under the terms of his plan." Finally, the criminal and civil sanctions of ERISA provide no relief to an employee who was defrauded by means of an oral communication. Criminal and civil sanctions under ERISA are imposed only upon those who misstate or refuse to report material information, and those who refuse to remit benefits due the beneficiary. The antifraud provisions of the 1933 and 1934 Acts are specifically made applicable to oral misstatements or omissions of material facts.

In light of the incomplete recovery ERISA provides a defrauded employee, the application of the antifraud provisions of the 1933 and 1934 Acts to an interest in a pension plan should provide the defrauded employee a full recovery. Thus, the combination of the reporting requirements and sanctions of both ERISA and the 1933 and 1934 Acts will ensure that the employee who is asked to accept an interest in a pension plan, even if it is noncontributory and compulsory, will be made aware of all material facts upon which to make his investment decision. As an incentive for employers and pension plan administrators and trustees to make full disclosure, ERISA provides criminal sanctions, declaratory and injunctive relief and compensation to the participant from whom information or benefits were wrongfully withheld. In addition, if the participant in the pension plan is defrauded, under the antifraud provisions of the 1933 and 1934 Acts he is now assured a full recovery regardless of his eligibility for benefits under the terms of his plan.

The Future of Daniel

Federal regulation of health benefit and retirement plans is well established. ERISA was designed to protect the interests of employees from fraud and mismanagement of their pension funds by setting minimum standards for the establishment and administration of pension plans. From the viewpoint of many participant-investors,
such protection is inadequate.

The Supreme Court has granted certiorari in Daniel v. International Brotherhood of Teamsters. The Court, of course, has many options. First, the Court could reverse by holding that an interest in a noncontributory, compulsory pension plan is not a security under the 1933 and 1934 Acts. This would involve a finding that such an interest did not satisfy the investment contract test for determining what is a security. Second, the Court could reverse by holding that even if such interest was a security, it was not obtained in a sale. This option would revitalize the SEC’s no sale theory, which the SEC itself abandoned in the district court and court of appeals. Either of these alternatives would leave Daniel without a cause of action other than for common law fraud.

Alternatively, the Court could hold that although the fraud alleged by Daniel commenced prior to the effective date of ERISA, the fraud is continuing in nature and, under the equitable powers conferred by ERISA, the district court may fashion a remedy to award Daniel pension benefits. Such a holding would avoid the problem of dealing with the definitions of security and sale under the 1933 and 1934 Acts.

As another option, the Court could hold that only plaintiffs ineligible to recover under ERISA, due to the fact that the allegedly fraudulent acts occurred prior to that Act’s effective date, may sue under the antifraud provisions of the 1933 and 1934 Acts. By this limitation, the Court could avoid the possible joint application of the sanctions of ERISA and the 1933 and 1934 Acts. However, requiring persons to whom ERISA applies to sue exclusively thereunder may pose a problem to plaintiffs who wish to bring suit for alleged oral misstatements or to whom no benefits are due under the terms of the pension plan. For this reason, this alternative is not attractive to all potential plaintiffs.

CONCLUSION

Whether the necessary protection is provided by the federal securities laws or ERISA, the key concept is to provide defrauded participants in pension plans a well-defined cause of action supplying them an adequate remedy. The federal securities laws have been applied for over forty years to protect investors. In the context of a noncontributory, compulsory pension plan, the 1933 and 1934 Acts could operate efficiently and without undue hardship to provide an adequate recovery from fraudulent activity. The Supreme Court should address the issues of the definitions of security and sale under the 1933 and 1934 Acts. The Court has the opportunity to limit its holding to situations where ERISA provides no remedy.
Regardless of the option the Supreme Court chooses, to effectuate the policies and purposes behind ERISA and the federal securities laws, the interests of participants in pension plans must be of the utmost concern.

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