

The Federal Securities Laws and Employee Pension Participants: Retiring *Daniel*

Nearly half of the American industrial labor force has come to rely on private pension plans for financial assistance upon retirement.¹ Concern, stimulated by the size and growth of plan holdings,² that employee pension expectations are often not fulfilled³ has led to increasing federal protection.⁴ In 1974, Congress enacted the first major

1. S. REP. No. 127, 93d Cong., 2d Sess. 3 (1973), reprinted in [1974] U.S. CODE CONG. & AD. NEWS 4839-40 [hereinafter cited as ERISA SENATE REPORT with page citation to [1974] U.S. CODE CONG. & AD. NEWS]; cf. Heidbreder, Kolodrubetz & Skolnik, *Old-Age Income Programs*, in JOINT ECONOMIC COMMITTEE, 90TH CONG., 1ST SESS., OLD AGE INCOME ASSURANCE, pt. 2, at 93 (Comm. Print 1967) (private pension benefits mean difference between less-than-modest and reasonably comfortable level of existence upon retirement). For an overview of the operation of private pension plans, see D. MCGILL, *FUNDAMENTALS OF PRIVATE PENSIONS* (3d ed. 1975).

2. The assets of private pension plans currently exceed \$180 billion and are growing at an average rate of \$14 billion a year. See E. ALLEN, J. MELONE & J. ROSENBLOOM, *PENSION PLANNING 2* (3d ed. 1976). Prior to the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified principally at 29 U.S.C. §§ 1001-1381 (Supp. V 1975) (labor provisions) and in scattered sections of 26 U.S.C. (tax provisions)), private pension plans constituted "the only large private accumulation of funds which [had] escaped the imprimatur of effective federal regulation." ERISA SENATE REPORT, *supra* note 1, at 4840.

3. For essentially two reasons, the probability that a pension participant will receive benefits has traditionally been quite low. First, an employee's plan could terminate without resources sufficient to cover its liabilities. Such underfunding could result from irresponsible, incompetent, or fraudulent plan management, ills that have continuously plagued private pension funds. See, e.g., *Private Welfare and Pension Plan Legislation: Hearings on H.R. 1045, H.R. 1046 and H.R. 16462 Before the General Subcomm. on Labor of the House Comm. on Education and Labor*, 91st Cong., 1st & 2d Sess. 470-72, 475 (1970) (insider misconduct) [hereinafter cited as *1970 House Hearings*]; 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. 71-72 (1971) (inadequate funding) [hereinafter cited as INTERIM REPORT]. Second, an employee could fail to satisfy a plan's eligibility requirements. These requirements have tended to be harsh, involving stringent age and service requirements. Forfeiture could occur as a result of "natural" events over which the employee had no control, such as a layoff or illness. See H.R. REP. No. 533, 93d Cong., 2d Sess. 5 (1973), reprinted in [1974] U.S. CODE CONG. & AD. NEWS 4643 (inequitable benefit eligibility requirements) [hereinafter cited as ERISA HOUSE REPORT with page citation to [1974] U.S. CODE CONG. & AD. NEWS]. For a general description of these risks and the hardships they have caused employees, see R. NADER & K. BLACKWELL, *YOU AND YOUR PENSION* 1-91 (1973).

4. The federal pension reform movement that culminated in the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified principally at 29 U.S.C. §§ 1001-1381 (Supp. V 1975) and in scattered sections of the Internal Revenue Code), began in 1958 with the enactment of the Welfare and Pension Plans Disclosure Act (WPPDA), Pub. L. No. 85-836, 72 Stat. 997 (codified at 29 U.S.C.

pension reform legislation, the Employee Retirement Income Security Act (ERISA).⁵

Recently courts have been asked to decide whether employees enrolled in pension plans are also covered by the Securities Act of 1933 (1933 Act)⁶ and the Securities Exchange Act of 1934 (1934 Act).⁷ In *Daniel v. International Brotherhood of Teamsters*,⁸ the first court of appeals to face the question held that employee interests in noncon-

§§ 301-309 (1958)) (amended 1962) (repealed 1975 by ERISA) (requiring plan fiduciaries to prepare and file description and annual report of plan with Secretary of Labor and send it to participants upon written request). Cf. Statement by the President Upon Signing the Welfare and Pension Plans Disclosure Act, PUB. PAPERS ¶ 235 (Aug. 29, 1958) ("I have approved [the WPPDA] because it establishes a precedent of Federal responsibility in this area. It does little else.") In 1962, President Kennedy, who had been chairman of the Senate subcommittee charged with overseeing the enactment of the WPPDA, appointed a Cabinet committee to conduct an investigation and assessment of laws that governed private pension and other employee retirement income programs. The committee reported its findings to President Johnson on January 15, 1965. See PRESIDENT'S COMM. ON CORP. PENSION FUNDS AND OTHER PRIVATE RETIREMENT AND WELFARE PROGRAMS, PUBLIC POLICY AND PRIVATE PENSION PROGRAMS (1965). Soon thereafter, congressional committees began consideration of the legislation that evolved into ERISA. See, e.g., *Pension and Welfare Plans: Hearing on S. 3421, S. 1024, S. 1103 and S. 1255 Before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare*, 90th Cong., 2d Sess. (1968).

Tax qualified plans have been subject to peripheral regulation under the Internal Revenue Code since 1942. I.R.C. §§ 401-404, 501-503 (amended 1974 by ERISA); see D. MCGILL, *supra* note 1, at 30-32. Plans administered jointly by an employer and a union have been regulated in a limited way since 1947 under Labor-Management Relations Act § 302. See 29 U.S.C. § 186 (1970 & Supp. V 1975) (original version at ch. 120, § 302, 61 Stat. 157-58 (1947)); ERISA HOUSE REPORT, *supra* note 3, at 4642.

For a more comprehensive discussion of pre-ERISA pension regulation, see INTERIM REPORT, *supra* note 3, at 23-27, 91-99; E. PATTERSON, LEGAL PROTECTION OF PRIVATE PENSION EXPECTATIONS (1960).

5. Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified principally at 29 U.S.C. §§ 1001-1381 (Supp. V 1975) (labor provisions) and in scattered sections of 26 U.S.C. (tax provisions)). For an overview of the statute, see Comment, *The Employee Retirement Income Security Act of 1974: Policies and Problems*, 26 SYRACUSE L. REV. 539 (1975).

6. 15 U.S.C. §§ 77a-77aaa (1970 & Supp. V 1975).

7. 15 U.S.C. §§ 78a-78jj (1970 & Supp. V 1975). Litigants in two such cases have successfully argued that their claims are actionable under the Acts. See *Schlansky v. United Merchants & Mfrs.*, 443 F. Supp. 1054 (S.D.N.Y. 1977); *Daniel v. International Bhd. of Teamsters*, 410 F. Supp. 541, 546-52 (N.D. Ill. 1976), *aff'd*, 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 98 S. Ct. 1232 (1978) (Nos. 77-753 & 77-754). Litigants in a number of other actions have been unsuccessful. See *Cinnamon v. Brooks*, No. CV-77-204 LTL (C.D. Cal., securities laws claim dismissed Nov. 8, 1977); *Wiens v. International Bhd. of Teamsters*, 397 SEC. REG. L. REP. (BNA) A-13 (C.D. Cal. Mar. 28, 1977) (bench opinion); *Hurn v. Retirement Fund Trust*, 424 F. Supp. 80, 81-82 (C.D. Cal. 1976); cf. *Robinson v. UMW Health & Retirement Funds*, 435 F. Supp. 245, 246-47 (D.D.C. 1977) (employee interests in welfare benefit plans not subject to federal securities laws). Several other actions await decision. See *Petition for a Writ of Certiorari to the U.S. Court of Appeals for the Seventh Circuit*, app. A, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 98 S. Ct. 1232 (1978) (No. 77-753) (citing 12 pending cases).

8. 561 F.2d 1223 (7th Cir. 1977), *cert. granted*, 98 S. Ct. 1232 (1978) (Nos. 77-753 & 77-754).

tributory and compulsory,⁹ defined benefit¹⁰ pension plans are securities subject to the Acts' antifraud provisions.¹¹ The Supreme Court has granted certiorari.¹²

This Note argues that neither the antifraud nor any other provisions

9. In a noncontributory plan, the employer makes contributions to the plan on behalf of participating employees; the employees do not, absent special arrangements, make contributions themselves. See D. MCGILL, *supra* note 1, at 154-58. Noncontributory plans are almost always compulsory, *i.e.*, employees cannot prevent contributions from being made on their behalf. Interview with Dan McGill, Chairman and Research Director of Pension Research Council, Wharton School, University of Pennsylvania (Apr. 10, 1978) (notes on file with *Yale Law Journal*).

Eighty percent of all private pension plan participants are enrolled in noncontributory and compulsory plans, J. SCHULZ, *THE ECONOMICS OF AGING* 116 (1976), and the percentage is expected to grow, E. ALLEN, J. MELONE & J. ROSENBLOOM, *supra* note 2, at 58. This is true for tax reasons, see I.R.C. §§ 402, 404 (employees can defer payment of tax on employer contributions made on their behalf until they actually receive benefits; employer contributions deductible); see generally Haddad, *Impact of Tax Policy on Private Pensions*, in *PENSIONS: PROBLEMS AND TRENDS* 63 (D. McGill ed. 1955), for actuarial reasons, see J. SCHULZ, *supra* at 83, and because it greatly simplifies plan administration, D. MCGILL, *supra* note 1, at 155.

10. In a defined benefit plan, the amount of benefits to be received by an employee is fixed in advance. The employer must adjust his contribution to whatever level is necessary to provide these benefits. In a defined contribution ("money-purchase") plan, by contrast, the level of employer contributions is set in advance, and the employee receives whatever level of benefits the contributions as invested by the plan will provide. See D. MCGILL, *supra* note 1, at 91-109.

Private plans are seldom operated on a defined contribution basis. *Id.* at 97; *cf.* Hurd, *Defined Benefit Plans: An Endangered Species?* 114 *TRUSTS & EST.* 206 (1975) (fears that peculiarities of ERISA will significantly reduce popularity of defined benefit plans and increase number of defined contribution plans probably unfounded). Multi-employer, collectively bargained plans such as that at issue in *Daniel* often purport to fix both benefits and contributions but are normally funded on, see E. ALLEN, J. MELONE & J. ROSENBLOOM, *supra* note 2, at 93, and in any case make payments on, see J. SCHULZ, *supra* note 9, at 117, a defined benefit basis. See generally E. ALLEN, J. MELONE & J. ROSENBLOOM, *supra* note 2, at 66-94.

11. 561 F.2d at 1233-44. The *Daniel* position is in the minority of the decided cases dealing with the question. See note 7 *supra* (citing cases).

12. 98 S. Ct. 1232 (1978) (Nos. 77-753 & 77-754). *Daniel* has received attention in Congress, see, *e.g.*, 435 SEC. REG. & L. REP. (BNA) A-5 (Jan. 11, 1978) (possibility of legislation); 159 PENSION REP. (BNA) A-16 (Oct. 17, 1977) (describing hearing), in professional publications, see, *e.g.*, Alef & Short, *Problems created by CA-7 decision that pension plan participation is a security*, 47 J. TAX. 282 (1977); Report, *Daniel v. International Brotherhood of Teamsters, A Report to the Committee on Federal Regulation of Securities from the Study Group of 1933 Act*, 32 BUS. LAW. 1925 (1977) (discussing district court decision), and in professional meetings, see, *e.g.*, 438 SEC. REG. & L. REP. (BNA) A-24 (Feb. 1, 1978) (*Daniel* one of premier issues at Fifth Annual Securities Regulation Institute); 29 PENSION & PROFIT SHARING REP. (P-H) ¶ 29.12 (Oct. 28, 1977) (ALI-ABA conference called to discuss *Daniel* decision). The *Daniel* district court decision has been analyzed in a number of law reviews. See Comment, *Securities Regulation of Employee Pension Plans: In the Wake of the Daniel Decision*, 38 U. PITT. L. REV. 697 (1977); 10 CREIGHTON L. REV. 394 (1976); 15 DUQ. L. REV. 359 (1976-1977); 5 FORDHAM URB. L.J. 591 (1977); 2 J. CORP. L. 421 (1977); 22 VILL. L. REV. 195 (1976-1977). For law review commentary on the Seventh Circuit opinion, see Comment, *Interest in Pension Plans as Securities: Daniel v. International Brotherhood of Teamsters*, 78 COLUM. L. REV. 184 (1978); Comment, *Application of the Securities Laws to Noncontributory, Defined Benefit Pension Plans*, 45 U. CHI. L. REV. 124 (1977) [hereinafter cited as *Chicago Comment*] 52 N.Y.U.L. REV. 1175 (1978).

of the securities laws should apply to employee pension interests.¹³ The Note accepts *Daniel's* finding that pension plan interests are "securities" within the prevailing definition set by the Supreme Court. It argues, however, that in determining whether the Acts apply courts should also consider whether regulation would be consistent with the Acts' intended purposes. Although *Daniel* undertook such an analysis, it failed to focus on what should have been its central concern: whether employee pension participants are within the class of persons the statutes, functionally considered, were intended to protect. After determining the characteristics of this class and suggesting its past importance in judicial interpretations of the securities laws, the Note examines the characteristics of pension participants and the quality of their protection under ERISA. It concludes that the Acts could not have been intended to regulate pension participants and thus should not apply.

I. *Daniel v. International Brotherhood of Teamsters:*
Pension Interests as Securities

In *Daniel*, the Seventh Circuit sustained a pre-ERISA cause of action by retired truck driver John Daniel who alleged that the trustees of his pension plan had misrepresented plan eligibility requirements in a way that had cost him his expected benefits.¹⁴ The complaint was

13. In this Note, the term "pension interest" refers to an employee interest in a non-contributory and compulsory, defined benefit private pension plan. The overwhelming majority of large corporate and union plans are of this type. See notes 9 & 10 *supra*. Voluntary and contributory plans and defined contribution plans are left to be treated elsewhere, as are Keogh (sometimes known as H.R. 10) plans for self-employed persons and their employees, and individual retirement accounts (IRAs) for individuals not otherwise covered by a tax qualified plan. Any consideration of the status of these pension arrangements under the securities laws should take into account their different legislative and administrative histories as well as their different relations to their participants or users. For a description of these plans and devices, see E. ALLEN, J. MELONE & J. ROSENBLUM, *supra* note 2, at 325-50.

14. See 561 F.2d 1223, 1225-29 (7th Cir. 1977), *cert. granted*, 98 S. Ct. 1232 (1978) (Nos. 77-753 & 77-754). Under the Local 705 pension plan in which Daniel was enrolled, an employee had to complete 20 continuous years of covered service to qualify for benefits. *Id.* at 1226. In the tenth year of his nearly 23 years of covered service, Daniel was involuntarily laid off for four months because of the adverse economic condition of his employer. As a result, he was denied a pension. *Id.* In addition to seeking class relief under National Labor Relations Act § 9(a), 29 U.S.C. § 159(a) (1970) (union duty of fair representation), Labor-Management Relations Act § 302(c)(5), 29 U.S.C. § 186(c)(5) (Supp. V 1975) (pension fund must be established for sole and exclusive benefit of employees), and common law theories of breach of fiduciary duty, fraud, and deceit, 561 F.2d at 1227 n.3, Daniel sued under 1934 Act § 10(b) and Rule 10b-5, and 1933 Act § 17(a), alleging that the union local and international had misrepresented plan eligibility requirements. *Id.* at 1226-27. The Northern District of Illinois denied defendants' motions to dismiss the securities laws claims, 410 F. Supp. at 544-53, and the Seventh Circuit affirmed, 561 F.2d at 1229.

held actionable under the antifraud provisions of the 1933 and 1934 Acts,¹⁵ which the court expressly held applied to pension plan interests,¹⁶ both before and after ERISA.¹⁷

The court recognized that a necessary condition for applying the Acts is that the interest at issue fall within the definition of a security adopted by the Supreme Court in 1946 in *SEC v. W.J. Howey Co.*¹⁸ According to the *Howey* test, a security is involved in any transaction "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."¹⁹

Given the vagueness of such a test,²⁰ the Seventh Circuit's decision

15. 1933 Act § 17(a), 15 U.S.C. § 77q(a) (1970); 1934 Act § 10(b), 15 U.S.C. § 78j(b) (1970). It is well-established that 1934 Act § 10(b) gives rise to a private cause of action. See *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 13 n.9 (1971). In *Daniel*, the Seventh Circuit held that 1933 Act § 17(a) also gives rise to such a cause of action. 561 F.2d at 1244-46; accord, *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1283-84 (2d Cir. 1969), cert. denied, 397 U.S. 913 (1970).

16. 561 F.2d at 1229. The court's holding rested not only on its finding that pension interests are securities to which the Acts apply, *id.* at 1242, but also on an ancillary determination that such securities are acquired in the statutorily required "sale," *id.* at 1242-44. Because this Note concludes that pension interests are not securities to which the Acts apply, it does not discuss the question of whether their acquisition would constitute a sale. The statutory "sale" definition, it should be noted, requires only the "disposition of a security . . . for value." 1933 Act § 2(3), 15 U.S.C. § 77b(3) (1970).

17. Because *Daniel's* cause of action arose prior to the effective date of ERISA, 561 F.2d at 1248 n.57, the Seventh Circuit need not have considered ERISA in reaching its decision. The court nevertheless decided to do so, concluding that such consideration argued for rather than against application of the securities laws. *Id.* at 1246-49.

18. 328 U.S. 293 (1946). Section 2(1) of the 1933 Act defines a "security" as: any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(1) (1970). For most purposes, including that of applying *Howey*, 328 U.S. 293 (1946), the 1934 Act definition may be considered the same. See *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 847 n.12 (1975); cf. *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1131-39 (2d Cir. 1976) (discussing Acts' differential treatment of commercial paper). *Howey* has become the standard for determining the existence of an "investment contract," which has been taken to be the definition's catchall term. *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975); Hannan & Thomas, *The Importance of Economic Reality and Risk in Defining Federal Securities*, 25 HASTINGS L.J. 219, 225 (1974); see Annot., 3 A.L.R. Fed. 592 (1970) (citing cases). *Howey* was the second Supreme Court security definition case, see *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943), but the first to articulate a formulaic test.

19. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

20. See, e.g., *Ivan Allen Co. v. United States*, 422 U.S. 617, 642-43 (1975) (Powell, J., dissenting) (meaning of security "not always self-evident, as can be seen by examining some of the extensive litigation on this question"); Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 OKLA. L. REV. 135, 138 (1971)

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that employee interests in pension plans fall within its confines was arguably correct,²¹ even though contrary interpretations are also plausible.²² Read in light of its judicial interpretation, the test supports the court's conclusions that the employee's interest qualifies as an "investment,"²³ that the pension fund constitutes a "common enterprise,"²⁴ that the employee is "led to expect profits,"²⁵ and that the

(outside "common garden variety" of securities, "problems of definition and classification multiply rapidly and guidelines tend to be obscure"). The statutory definitions are themselves extremely obscure. See *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 847 (1975) ("Congress did not attempt to articulate the relevant economic criteria for distinguishing 'securities' from 'non-securities'"); Hannan & Thomas, *supra* note 18, at 219 (meaning of security as used in Acts "one of the best kept secrets in recent legal history").

21. See, e.g., Hipple & Harkleroad, *Anomalies of SEC Enforcement: Two Areas of Concern*, 24 EMORY L.J. 697, 701 (1975) (interests in *Daniel*-type plans fit *Howey* test "fairly closely"); Overman, *Registration and Exemption from Registration of Employee Compensation Plans Under the Federal Securities Laws*, 28 VAND. L. REV. 455, 456 (1975) (interests in all types of pension plans may satisfy *Howey* test). It was the consensus of a recent Securities Regulation Institute panel on *Daniel* that the plan at issue in the case fit the *Howey* definition as currently interpreted. See 438 SEC. REG. & L. REP. (BNA) A-26 (Feb. 21, 1978).

22. See, e.g., Alef & Short, *supra* note 12, at 283-84 (defined benefit plan payouts not profits in *Howey* sense); *Chicago Comment*, *supra* note 12, at 137-45 (employee pension participants cannot be said to make investments for profit).

23. 561 F.2d at 1231-33. For the purposes of the *Howey* test, a person is said to invest in an enterprise when he relinquishes money, or some other resource, e.g., *El Khadem v. Equity Sec. Corp.*, 494 F.2d 1224, 1225 (9th Cir.), *cert. denied*, 419 U.S. 900 (1974) (rehypothecatable collateral and assignable promissory note), see Hannan & Thomas, *supra* note 18, at 236 (suggesting that *Howey* did not mean to exclude investor who furnishes property or services), in exchange for a right to share in the enterprise's returns. See *Chicago Comment*, *supra* note 12, at 137. *Daniel* reasoned that an employee invests in his pension fund because he makes an indirect contribution to the fund, see 561 F.2d at 1232 (employer contributions are form of employee compensation otherwise receivable as wages), in return for a contingent interest in the fund's future benefit payments. *Id.* at 1223; *cf. id.* ("mere contingent expectations are the rule rather than the exception in the equity [security] markets"). The court's finding that employer contributions are essentially forgone wages is questionable. See, e.g., *Alabama Power Co. v. Davis*, 431 U.S. 581, 593 (1977) (pension benefits not compensation for services rendered but right of seniority that must be credited to veteran under § 9 of Military Selective Service Act, which requires employers to rehire returning veterans without loss of seniority). Nonetheless it is generally accepted that employer contributions are a form of compensation. See, e.g., ERISA HOUSE REPORT, *supra* note 3, at 4839 (pension benefits "form of deferred wages"); S. REP. No. 1440, 85th Cong., 2d Sess. 4, *reprinted in* [1958] U.S. CODE CONG. & AD. NEWS 4137, 4139 (employer contributions "form of compensation"); *cf. Alabama Power Co. v. Davis*, 431 U.S. 581, 593 (1977) (pension benefits a "reward" for length of service). Thus employer contributions would appear to satisfy the investment element of *Howey*. See Hannan & Thomas, *supra* note 18, at 236.

24. 561 F.2d at 1233. *Daniel's* finding that a pension fund is a common enterprise because it is a trust fund investing in the capital markets in which employees have undivided interests has not been an object of controversy. See *Chicago Comment*, *supra* note 12, at 135 (common enterprise "clearly involved" in *Daniel* plan); *cf. Coffey, The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367, 374 n.41 (1967) (noting possible common enterprise situations of which *Daniel* plan would be one). See generally *id.* at 374 (*Howey* common enterprise term particularly ill-defined).

25. 561 F.2d at 1233-35. Having determined that the pension benefits promised an employee are expected to exceed the employer contributions made on his behalf, the

profits result solely from the efforts of others.²⁶

Daniel properly reasoned, however, that, in deciding whether to apply the Acts, it should supplement its determination that pension interests are securities with an inquiry into whether regulation of such interests would serve the purposes of the Acts.²⁷ In undertaking this inquiry, the court identified three elements of concern: the Acts' legislative history, the position of the Securities and Exchange Commission (SEC), and, to the extent that analysis of these elements was not dispositive, additional considerations of policy.²⁸ The court concluded that Congress has on occasion indicated that the Acts apply to pension interests and that the SEC has consistently taken such a position administratively since at least 1941.²⁹ Were the first of these conclusions warranted, *Daniel* would have to be accepted; were the second warranted, *Daniel* would at least be more defensible. But both conclusions are subject to challenge sufficient to leave the intent

court reasonably concluded, given its characterization of the contributions as the employee's investment, *see* note 23 *supra*; *but see Chicago Comment, supra* note 12, at 143 (employer contributions cannot be equated to employee investment), that the excess was a *Howey*-type profit. *See* 561 F.2d at 1234. Although part of this excess can usually be attributed to factors, such as benefit forfeitures by employees with only partially accrued or vested benefit rights and negotiated increases in per capita contribution levels, the profits nature of which is controversial, *see id.*, a substantial part of the excess derives from accumulated earnings realized from the fund's management, *id.*, that are much more clearly profits within the meaning of *Howey*. *See* *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 (1975) (defining *Howey* profits as "either capital appreciation resulting from the development of the initial investment . . . , or a participation in earnings resulting from the use of investors' funds"); *cf. Alef & Short, supra* note 12, at 284 (prospect of such earnings was held out to *Daniel* plan participants). Commentators have argued that because the amount of pension benefits paid out by a *Daniel*-type plan is predefined and depends only remotely on the amount of these earnings, participants cannot be said to expect profits. *See id.* at 283-84. *But see Hannan & Thomas, supra* note 18, at 238 (*Howey* profits can refer to "distributions which are fixed, . . . or unrelated to the profits as reflected in the balance sheet of the enterprise").

26. 561 F.2d at 1233 (pension fund trustees exercised exclusive control over fund); *id.* at n.21 (defendants did not contest conclusion that what court called profits derived solely from efforts of persons other than employees). *See also* note 67 *infra* (noting criticism of *Howey*'s "solely from the efforts of others" requirement).

27. 561 F.2d at 1229. Such an inquiry seems particularly relevant given the uncertainties of the *Howey* standard. *See* note 20 *supra*.

28. 561 F.2d at 1229. The court equated its approach with that of the Supreme Court in such recent securities cases as *Piper v. Chris-Craft Indus., Inc.* 430 U.S. 1 (1977). 561 F.2d at 1229. Its approach resembles more closely that of the Supreme Court in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), a securities definition case decided on writ of certiorari to the Seventh Circuit.

29. 561 F.2d at 1237-41. The Commission filed an amicus curiae brief in the Seventh Circuit arguing for the court's eventual result. *See* Brief for Securities and Exchange Commission, Amicus Curiae, at 61, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977) [hereinafter cited as SEC Brief]. The Department of Labor, it should be noted, argued for a contrary position. *See* Brief for the Secretary of Labor as Amicus Curiae, at 34, *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223 (7th Cir. 1977) [hereinafter cited as Labor Brief]. In asking the Supreme Court to review the case, the Solicitor General did not take a position on the merits. 441 SEC. REG. & L. REP. A-13 (Feb. 22, 1978).

of Congress and the authority of the view of the SEC in doubt. The Acts' legislative history provides at best ambiguous support for the court's decision.³⁰ The Commission's position, because of the cir-

30. The court found essentially two sources of congressional support for its position. First, it discerned evidence of a congressional intent to regulate pension interests under the securities laws in the ultimate rejection of an amendment to the 1933 Act that had been adopted by the Senate in 1934. 561 F.2d at 1237-38. The amendment sought to exempt from registration offerings to employees made "in connection with a bona fide plan for the payment of extra compensation or stock-investment plan," 78 CONG. REC. 8708 (1934) (quoting amendment), but it was eliminated in conference on the ground that registration of such offerings was justified, see H.R. REP. NO. 1838, 73d Cong., 2d Sess. 41 (1934). Second, the court concluded that the Investment Company Amendments Act of 1970, Pub. L. No. 91-547, §§ 27(b), 28(a), 84 Stat. 1434 (amending 15 U.S.C. §§ 77c(a)(2), 78c(a)(12) (1964)), exempted employee pension interests from the 1933 and 1934 Acts' registration provisions, see 15 U.S.C. §§ 77c(a)(2), 78c(a)(12) (1970), and thus created a negative implication that such interests are securities subject to the Acts' provisions against fraud. 561 F.2d 1239-41; cf. 1 L. LOSS, SECURITIES REGULATION 710 (2d ed. 1961) (1933 Act security and transaction exemptions extend to registration but not to all anti-fraud provisions of Act); R. JENNINGS & H. MARSH, SECURITIES REGULATION: CASES AND MATERIALS 856 (4th ed. 1977) (1934 Act exemptions not applicable to actions brought under Rule 10b-5).

Each of these interpretations seems mistaken. The 1934 amendment refers not to pension plans but to employee stock purchase and stock bonus plans, see 1 L. LOSS, *supra* at 506, which cast the employee participant in a significantly different investment role than do pension plans, as Congress has recognized, see 15 U.S.C. § 77c(a)(2)(i) (1970) (codifying SEC position that employee interests in plans that purchase employer-related stock and securities in excess of employer contributions are securities subject to registration); S. REP. NO. 184, 91st Cong., 2d Sess. 11, reprinted in [1970] U.S. CODE CONG. & AD. NEWS 4907-08 (such plans—unlike *Daniel*-type pension plans—are potential vehicles for direct market investment by individual members of public) [hereinafter cited as 1970 SENATE REPORT, with page citation to [1970] U.S. CODE CONG. & AD. NEWS]. Pension plans were a rarity at the time the Acts were passed, see N. TURE, THE FUTURE OF PRIVATE PENSION PLANS 13 (1976), and are not specifically mentioned anywhere in the original Acts or their pre-enactment history, see 1 L. LOSS, *supra* at 506.

The 1970 Amendments did not cover employee pension interests either. Congress's express objective in enacting the portion of the Amendments on which the *Daniel* court focused was to clarify the application of the securities laws to solicitations of pension asset management business by banks and insurance companies. See 1970 SENATE REPORT, *supra* at 4898, 4917-18; cf. Letter from Bartley Fleming, Jr., Senior Trust Officer, Chemical Bank, (Oct. 26, 1977) (on file with *Yale Law Journal*) ("services to [employee benefit plan] sponsors are actively (to say the least) sold"). To that end, the Amendments exempted offerings of interests in management funds and accounts made by banks and insurance companies to pension plan sponsors. 15 U.S.C. §§ 77c(a)(2), 78c(a)(12) (1970). The status of employee pension interests under the securities laws was not considered. *Daniel* based its contrary conclusion principally on an interpretation of a letter considered by one of the subcommittees that had handled the Amendments. 561 F.2d at 1240-41; see Letter from Stannard Dunn, General Counsel, Sperry Rand Corp., to Rep. John Moss (Nov. 7, 1969), reprinted in *Mutual Fund Amendments: Hearings on H.R. 11995, S. 224, H.R. 13754 and H.R. 14737 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 91st Cong., 1st Sess. 929-31 (1969) [hereinafter cited as Dunn Letter with page citation to hearings]. Because the letter asked Congress to exempt employee pension interests from the Acts' registration requirements, *id.* at 930, and because it was the apparent cause of the Amendments' exemption of interests in "single or collective" bank and insurance company funds and accounts, 1933 Act § 3(a)(2), 15 U.S.C. § 77c(a)(2) (1970) (emphasis added), *Daniel* concluded that "single" referred to pension interests of individual employees. 561 F.2d at 1241; see Lybecker, *Bank-Sponsored Investment Management Services: A Legal History and Statutory Interpretative Analysis—Part 2*,

cumstances of its development, is not entitled to great weight.³¹

The court, perhaps itself aware of this uncertainty, attempted to buttress its opinion with an analysis of policy considerations. It described the importance of pension funds to employees and to the

5 SEC. REG. L.J. 195, 243-45 (1977) (reaching same conclusion). This conclusion, however, was misconceived. The letter suggests, as *Daniel* noted, that Congress codify the SEC's position that pension interests are securities exempt from registration. Dunn Letter, *supra* at 930. It proposes a change in the Amendments clearly to that effect. *Id.* at 931. But the letter also suggests that Congress exempt from registration the interests of plans in non-collective (single) bank funds and insurance company accounts in addition to the interests of plans in collective funds and accounts that the bill already so exempted. *Id.* at 929. It is this last suggestion, clearly relevant to Congress's desire to clarify the overall regulation of bank and insurance company pension fund solicitations, that the "single" exemption reflects. *Daniel's* reading to the contrary necessitates an inference of clumsy congressional draftsmanship. See Lybecker, *supra* at 243-44.

31. The Supreme Court has indicated that deference to the construction of a regulatory statute by the agency charged with the statute's enforcement is most appropriate when the construction has been long and consistently held, see *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977), has been acquiesced in by Congress, see *Chemehuevi Tribe v. FPC*, 420 U.S. 395, 410 (1975), and is consistent with the purpose of the statute, see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 213 (1976).

On each count, the SEC construction is questionable. First, the SEC's position in support of *Daniel* does not appear to have been a longstanding one. Although the Commission has consistently maintained that pension interests of all kinds are securities, it has never required *Daniel*-type pension interests to be registered. It has taken the position that such interests are not acquired in a statutory sale. See, e.g., Opinions of Assistant General Counsel of Commission [1941-1944 Transfer Binder] FED. SEC. L. SERV. (CCH) ¶ 75,195, reprinted in [1976] 1 FED. SEC. L. REP. (CCH) ¶ 2105.53; 1 L. LOSS, *supra* note 30, at 508; cf. 3 *id.* at 1421-30 (antifraud provisions not applicable absent sale, purchase or offer). Although the meaning of "sale" for purposes of the Acts' registration provisions may in some circumstances differ from the meaning of "sale" for purposes of the Act's antifraud provisions, see *SEC v. National Sec., Inc.*, 393 U.S. 453, 466 (1969) (exchange of stock in merger held to constitute sale for purposes of antifraud provisions despite SEC Rule 133 that there was no sale for purposes of registration provisions); but cf. SEC Rescission of Rule 133, 37 Fed. Reg. 23,632 (1972) ("anomalous" to differentiate between "sale" for purposes of registration provisions and "sale" for purposes of antifraud provisions), the Commission apparently never indicated that such was the case for its no-sale position on the registration of *Daniel*-type pension interests, see Letter from Sen. Harrison Williams to SEC Chairman Harold Williams (Dec. 13, 1977), reprinted in 433 SEC. REG. & L. REP. (BNA) I-4 (1977) ("In over forty years, there was no affirmative statement and, most importantly, no action that would have put Congress on notice.") [hereinafter cited as Sen. Williams Letter with page citation to 433 SEC. REG. & L. REP. (BNA)]. The Commission's first representation that such interests are acquired in a sale for purposes of the Acts' antifraud provisions seems to have come in its amicus brief to the Seventh Circuit in *Daniel*. See 561 F.2d at 1251 (Tone, J., concurring) (chastising Commission for not being "as candid as we might have hoped in acknowledging and explaining its change in position").

Second, Congress cannot be said to have acquiesced in the SEC's original position, much less the new twist given it in *Daniel*. In 1941, before the SEC had concluded that pension interests were not acquired in a sale for registration purposes, the Commission sought congressional confirmation of its view that employee pension interests, unless affirmatively exempted, were subject to registration. See Note, *Pension Plans as Securities*, 96 U. PA. L. REV. 549, 549-50 (1948). The SEC proposal was shelved with the outbreak of World War II, but not before Congressmen at House hearings indicated strong disapproval and suggested that the securities laws were never intended to apply. See, e.g., *Hearings on Proposed Amendments to the Securities Act of 1933 and to the Securities Exchange Act of 1934 Before the House Comm. on Interstate and Foreign Commerce, 77th Cong., 1st Sess.* 913 (1941) [hereinafter cited as *1941 Hearings*]; Mundheim & Hendersen, *Applicability of the*

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securities markets,³² reasoned that the Acts would be a useful complement to ERISA,³³ and predicted that their application would neither overburden plans nor have a disruptive effect on labor-management relations.³⁴ None of these arguments survives close scrutiny.³⁵ More

Federal Securities Laws to Pension and Profit-Sharing Plans, 29 LAW & CONTEMP. PROB. 795, 811-12 (1964). Since that time, at least until *Daniel*, Congress has not demonstrated any awareness of the issue of whether the Acts apply to pension interests. Congressional committee descriptions of what was thought to be existing pension regulation at the time of consideration of the WPPDA and ERISA suggest that Congress has never expected the securities laws to apply to pension interests. See, e.g., ERISA SENATE REPORT, *supra* note 1, at 4840; S. REP. NO. 1734, 84th Cong., 2d Sess. 60 (1956); cf. INTERIM REPORT, *supra* note 3, at 96 (noting SEC's no-sale position on registration but not mentioning possibility of anti-fraud coverage). See generally Sen. Williams Letter, *supra* at I-4 (Congress that passed ERISA did not expect, and would not have wanted, securities laws to apply). Finally, as this Note argues, the SEC's positions have been inconsistent with the purposes of the Acts. See pp. 1684-91 *infra*.

32. 561 F.2d at 1241-42.

33. *Id.* at 1246-49.

34. *Id.* at 1249-51.

35. Although the court correctly described pension funds as important for both workers and capital markets, see generally P. DRUCKER, *THE UNSEEN REVOLUTION: HOW PENSION FUND SOCIALISM CAME TO AMERICA* (1976); P. HARBRECHT, *PENSION FUNDS AND ECONOMIC POWER* (1959), it failed to note that there are other similarly important financial intermediaries that the securities laws were never intended to regulate, see, e.g., H.R. REP. NO. 85, 73d Cong., 1st Sess. 15 (1933) (insurance companies). Furthermore, the court did not realize the extent of the protections afforded employees by ERISA. See note 118 *infra*. See generally pp. 1687-91 *infra* (comparing securities laws and ERISA). Finally, the court seriously underestimated the likely costs of its holding and the probable effect of such costs on private pension plans' continued maintenance and growth. Application of the securities laws to pension interests would complicate the question of what information plans must disclose to participants in order to avoid liability. It would in effect destroy the "safe harbor" of adequate disclosure legislated in ERISA. Compare Memorandum from SEC Office of General Counsel to SEC Chairman Williams (Dec. 7, 1977), reprinted in 433 SEC. REG. & L. REP. (BNA) I-2 (1977) (as is generally true in securities field, adequacy of disclosure in pension context must be judged on case-by-case basis) [hereinafter cited as SEC Memorandum, with page citation to 433 SEC. REG. & L. REP. (BNA)] with Sen. Williams Letter, *supra* note 31, at I-4 (in ERISA, Congress set out rules governing disclosure so as to eliminate need for case-by-case judgments and accompanying uncertainty).

Application of the securities laws would also complicate the question of when disclosures must be made. Nimkin, *The Daniel Case*, 11 REV. SEC. REG. (Standard & Poor's) 972 (Feb. 28, 1978). If application would necessitate disclosure at a plan's adoption and during subsequent ratifications, as *Daniel*, 561 F.2d at 1248, and the SEC, SEC Memorandum, *supra* at I-2, indicated, it would significantly delay and disrupt collective bargaining negotiations. See Labor Brief, *supra* note 29, at 18 (calling such timing of disclosure "simply unsatisfactory from a labor relations point of view"); cf. U.S. DEP'T OF LABOR, CURRENT WAGE DEVELOPMENT, April 1976, at 52 (pervasiveness of pension questions in collective bargaining).

Further, the *Daniel* result, despite the court's assurances to the contrary, see, e.g., 561 F.2d at 1250, suggests that plans may have to register with the SEC. See Nimkin, *supra* at 967; cf. SEC Brief, *supra* note 29, at 39 (characterizing Commission's no-sale position with respect to registration as resting on very narrow view of meaning of "sale"). But see *id.* at 30-34 (explaining SEC view, criticized at note 30 *supra*, that pension interests were exempted from registration by 1970 Amendments). Depending on the SEC's requirements, registration could be expensive. Cf. N.Y. Times, Nov. 5, 1977, at 27 (\$93,000 to \$182,000 for typical company offering securities). See also U.S. OFFICE OF MANAGEMENT AND BUDGET, THE BUDGET OF THE UNITED STATES, app., 928-29 (1975) (SEC spent \$9.5 million in 1974 to

importantly, the court failed to consider what it should have recognized as dispositive—whether pension plan participants are the kind of investors the Acts, functionally considered, were intended to protect. In the next section this Note demonstrates the importance of considering the intended class of beneficiaries of the Acts and then sketches the characteristics of this class. In the following section it contrasts these characteristics with those of private pension participants.

II. The Intended Scope of the Securities Laws: Who is Protected?

The securities laws seek to protect investors and the efficiency of the nation's capital markets from the dangers created by overvaluation of securities.³⁶ Their approach, however, is deliberately modest.³⁷ Con-

process 12,000 registration and proxy statements, etc.); 71 PENSION REP. (BNA) R-9 (Feb. 2, 1976) (approximately 500,000 corporate pension plans expected to file with IRS and Department of Labor).

The new liabilities that application of the securities laws would entail are difficult to estimate. Present activity suggests that the number of claims would be great. See note 7 *supra* (noting 18 actions). Although the uninviting standard of proof that now confronts litigants under 1934 Act § 10(b), see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976) (plaintiff must allege scienter), makes unlikely the possibility that *Daniel*-type causes of action would result in liabilities that did not already exist at common law, see Haimoff, *Holmes Looks at Hochfelder and 10b-5*, 32 BUS. LAW. 147, 148 (1976) (*Hochfelder* standard no less stringent than that of common law), it has been suggested that application of the securities laws would nevertheless open the way for actions under other provisions of the Acts that would require a comparatively low standard of proof. See Nimkin, *supra* at 967. *But cf.* B. AARON, LEGAL STATUS OF EMPLOYEE BENEFIT RIGHTS UNDER PRIVATE PENSION PLANS 120 (1961) ("poor drafting of the plan instrument, inadequate funding, and unwise investment policies are far greater threats to the benefit rights of covered employees than is the dishonest or negligent administration of pension funds"). Whatever their chance of success the claims might well be expensive to litigate. *Cf.* *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740-49 (1975) (noting peculiar danger of "vexatious litigation" in federal securities laws field).

Daniel failed to recognize the sensitivity of private pension plans to costs and the consequent possibility that its holding would significantly inhibit their continued maintenance and growth. *Cf.* PENSION WORLD, Mar. 1977, at 38 (ERISA requirements prompted cancellation of 7,600 private pension plans in 1976 and brought 50% drop in number of new plans approved by Internal Revenue Service).

36. See H.R. REP. No. 85, 73d Cong., 1st Sess. 2-3 (1933). Although a desire to protect investors and markets from overvaluation due to promotional fraud was apparently the principal impetus for the Acts' adoption, the prevention of overvaluation resulting from information that is inadequate for some other reason has come to play a larger role in the Acts' administration. See V. BRUDNEY & M. CHIRELSTEIN, CASES AND MATERIALS ON CORPORATE FINANCE 717 (1972); *cf.* Kripke, *The SEC, The Accountants, Some Myths and Some Realities*, 45 N.Y.U.L. REV. 1151, 1188 (1970) (criticizing SEC accounting principles as outmoded reaction to widespread frauds of 1920s).

The actual value of the benefits bestowed by the Acts on investors and capital markets, given the regulatory costs, has been a matter of some dispute. For example, compare Bentson, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132, 152-53 (1973) (disclosure requirements of 1934 Act have had no measurable positive effect on securities traded on New York Stock Exchange) with Friend, *The SEC and the Economic Performance of Securities Markets*, in ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 185, 186 (H. Manne ed.

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gress in formulating the laws rejected proposals that would have lodged in the federal government extensive authority to evaluate and control the issuance and trading of securities.³⁸ It was believed that such a system of investor protection would interfere too seriously with business.³⁹ Instead, Congress designed the Acts to leave the responsibility for protection with the investor; the statutes were only to equip him with the means necessary to protect himself.⁴⁰

The means the statutes provide is disclosure;⁴¹ the Acts prescribe the right of investors and potential investors to information about the enterprises in which they invest.⁴² Registration and reporting provisions compel disclosure directly by requiring the filing and distribution of specified financial statements and operating information.⁴³

1969) (securities regulation has improved economic performance of stock market). *See also* J. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST AND MONEY* 147-63 (1935) (predominant activity of developed securities markets is forecasting psychology of market rather than prospective yield of assets).

37. *See* Douglas & Bates, *The Federal Securities Act of 1933*, 43 *YALE L.J.* 171, 171-73 (1933).

38. Landis, *The Legislative History of the Securities Act of 1933*, 28 *GEO. WASH. L. REV.* 29, 31 (1959).

39. *See* 1 L. Loss, *supra* note 30, at 121-28.

40. H.R. REP. No. 85, 73d Cong., 1st Sess. 8 (1933); *see* Douglas & Bates, *supra* note 37, at 171-72.

41. Parts of the Acts do concern matters other than disclosure but are not relevant here. *See, e.g.*, 1 L. Loss, *supra* note 30, at 130-31 (1934 Act seeks to control use of credit in and operation of exchanges and over-the-counter markets). The Acts' antifraud provisions, it should be emphasized, are disclosure provisions. Their principal purpose is to compel disclosure *in terrorem*. Retrospectively, they remedy only injury resulting from disclosure that has been insufficient. *See* Shulman, *Civil Liability and the Securities Act*, 43 *YALE L.J.* 227, 227 (1933). Although for a number of years the provisions were construed more as general fiduciary rules than as disclosure provisions, *see, e.g.*, Note, *Fiduciary Suits Under Rule 10b-5*, 1968 *DUKE L.J.* 791, 814-15, such a construction has recently been emphatically rejected by the Supreme Court. *See* *Santa Fe Indus. v. Green*, 430 U.S. 462, 478 (1977); *Biesenbach v. Guenther*, 442 *SEC. REG. & L. REP. (BNA)* A-6 (E.D. Pa., Feb. 15, 1978) (discussing *Green*). *But cf.* SEC Brief, *supra* note 29, at 5 (antifraud provisions "essentially a generalized prohibition against fraudulent activity"). In *Green*, the Court held that an allegation that a majority shareholder breached a fiduciary obligation to other shareholders by effecting a short-form merger under Delaware corporation law, without any allegation of a material misrepresentation or a material failure to disclose, did not state a claim under 1934 Act § 10(b). 430 U.S. at 464-71. Today an investor who would not find disclosure beneficial would not find the Acts' antifraud provisions useful. *See* *Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223, 1250-51 (7th Cir. 1977), *cert. granted*, 98 S. Ct. 1232 (1978) (Nos. 77-753 & 77-754) (to recover under securities laws, "employees must show . . . justifiable reliance on a material misrepresentation or omission causing them injury").

42. In addition to providing access to this information, the Acts assure access equal to that of other investors, whether they be enterprise insiders or market professionals. *See* V. BRUDNEY & M. CHIRELSTEIN, *supra* note 36, at 716-17. *But cf.* *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-49 (1975) (equal access assured only to actual purchasers and sellers).

43. V. BRUDNEY & M. CHIRELSTEIN, *supra* note 36, at 716. For a general discussion of the Acts' registration and reporting provisions, *see* 1 L. Loss, *supra* note 30, at 159-351 (1933 Act); 2 *id.* at 784-1164 (1934 Act).

Antifraud provisions compel disclosure indirectly by prohibiting transactions that in the absence of disclosure would constitute fraud.⁴⁴

The disclosure requirements protect investors, and promote efficient resource allocation, in two ways. First, the information disclosed serves a valuation function. By facilitating intelligent valuation of securities, disclosure enables investors to protect themselves from fraudulent "blue sky" schemes and from purchases of overvalued securities generally.⁴⁵ Efficiency is promoted because intelligent investment decisions encourage the flow of funds to those enterprises best able to use them⁴⁶ and prod all enterprises to pursue projects likely to generate maximum return.⁴⁷ Second, the information disclosed performs a publicity function. By threatening to publicly expose undesirable insider behavior, the disclosure provisions protect investors from undue depreciation of their holdings⁴⁸ and promote efficiency by deterring insiders from undertaking self-dealing projects.⁴⁹

To construe the Acts in accordance with their purpose, it must be recognized that the Acts were intended to aid only investors who can be protected in these ways. One must identify the characteristics of this intended class of investors and then determine whether the investors in question share these characteristics. Such "intended class" analysis has in the past played a significant role in judicial interpretation of the Acts.

The Supreme Court has focused most clearly on the intended class of beneficiaries in confronting an issue analogous to that of the Acts'

44. V. BRUDNEY & M. CHIRELSTEIN, *supra* note 36, at 716. For an overview of the Acts' antifraud provisions, see 3 L. LOSS, *supra* note 30, at 1421-30. See also note 41 *supra* (antifraud provisions not general fiduciary provisions).

45. See SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65, 77 (1959) (Brennan, J., concurring); SECURITIES AND EXCHANGE COMMISSION, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS (THE WHEAT REPORT) 49-50 (1969) [hereinafter cited as WHEAT REPORT]. "Blue sky" schemes, see *Hall v. Geiger-Jones Co.*, 242 U.S. 539, 550 (1917) (term refers to speculative schemes that have no more basis than so many feet of blue sky), are only one cause of securities overvaluation. Overvaluation may be and now usually is the result of information that is inadequate for some reason other than promotional fraud. See note 36 *supra*.

46. See W. BAUMOL, THE STOCK MARKET AND ECONOMIC EFFICIENCY 36 (1965).

47. See V. BRUDNEY & M. CHIRELSTEIN, *supra* note 36, at 981-82.

48. WHEAT REPORT, *supra* note 45, at 50-51 (noting, by way of illustration, discontinuance by one issuer of practice of making interest-free loans to officers, directors, and stockholders); see, e.g., Cary, *The Direction of Management Responsibility*, 18 BUS. LAW. 29, 30 (1962); Frankfurter, *The Securities Act: II*, FORTUNE, Aug. 1933, at 55. See generally L. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (rev. ed. 1932) ("Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants . . .")

49. Capital outlay for self-interested dealings, engaged in to maximize the insider's personal wealth rather than the enterprise's value, may prevent the financing of projects that would be relatively more efficient.

general coverage—the nature and extent of available remedies. In deciding whether the securities laws give rise to implied rights of action, the Court has asked whether implying such rights would benefit the class of persons for whose benefit the statutes were enacted.⁵⁰ *Piper v. Chris-Craft Industries, Inc.*,⁵¹ for example, held that the Williams Act⁵² did not create a cause of action for defeated tender offerors because a private right of action would not necessarily work to the benefit of the shareholders the Acts sought to protect.⁵³ Similarly, in determining whether corporate shareholders were entitled to antifraud protection in the disclosure of merger information, the Court in *SEC v. National Securities, Inc.*⁵⁴ inquired whether such shareholders had a need for information analogous to that of market purchasers and sellers of securities.⁵⁵ The Court concluded that they did because shareholders who vote in favor of mergers that ultimately take place lose their appraisal rights.⁵⁶ The Court therefore held that merger shareholders were within the intended class of beneficiaries of the Acts' antifraud provisions.⁵⁷

Consideration of the characteristics of the investors the Acts were intended to protect should, as the Court has implied, be equally important in determining the interests to which the Acts apply. In determining whether interests in certain unconventional insurance contracts fell within the "insurance" exemptions of the 1933 Act⁵⁸ and the Investment Company Act of 1940,⁵⁹ the Court in *SEC v. Variable*

50. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 22-42 (1977) (construing 1934 Act § 14(e)); *J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964) (construing 1934 Act § 14(a)); cf. *Cort v. Ash*, 422 U.S. 66, 78, 80-82 (1975) (construing criminal statute prohibiting corporations from making certain campaign contributions); *Texas & Pac. Ry. v. Rigsby*, 241 U.S. 33, 39 (1916) (construing Safety Appliance Act).

51. 430 U.S. 1 (1977).

52. Pub. L. No. 90-439, 82 Stat. 454 (1968) (amending 1934 Act §§ 13-14, 15 U.S.C. §§ 78m-78n (1964)) (codified at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (Supp. V 1965-1969), as amended, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1970)). The Williams Act was specifically designed to regulate tender offers. For a general discussion of the Act and tender offers, see E. ARANOW & H. EINHORN, *TENDER OFFERS FOR CORPORATE CONTROL* (1973).

53. 430 U.S. at 22-42. Analogously, in determining the reach of 1934 Act § 16(b), 15 U.S.C. § 78p(b) (1976), the Court has asked whether persons, although within the literal terms of the statute, were within the class of persons whose actions Congress had actually intended the section to deter. See *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 593-600 (1973); Note, *Exceptions to Liability under Section 16(b): A Systematic Approach*, 87 YALE L.J. 1430 (1978).

54. 393 U.S. 453 (1969).

55. *Id.* at 467.

56. *Id.* The Court also noted that shareholders would suffer a change in status as a result of the merger not unlike that involved in a typical market exchange. *Id.*

57. *Id.* at 467-68.

58. § 3(a)(8), 15 U.S.C. § 77c(a)(8) (1976); see H.R. REP. NO. 85, 73d Cong., 1st Sess. 15 (1933).

59. § 3(c)(3), 15 U.S.C. § 80a-3(c)(3) (1976).

*Annuity Life Insurance Co.*⁶⁰ and again in *SEC v. United Benefit Life Insurance Co.*⁶¹ asked in effect whether the holders of the interests were among those whom Congress had intended the exemption to include. The Court reasoned that by the exemption Congress had sought to exclude from the coverage of the Acts investors already protected by a well-established system of state insurance regulation.⁶² The interests at issue, which had not been in existence at the time Congress enacted the exemptions,⁶³ were held to be outside the exemptions because in each case their holders assumed investment risks that made the traditional protections of the state regulatory schemes of little use and the protections of the securities laws vital.⁶⁴

In the *Howey* case itself, the Court seemed attentive to the importance of determining whether the investors were within the Acts' intended class of beneficiaries.⁶⁵ Since *Howey*, courts have often merely applied the *Howey* formula without considering in detail whether the investors in question were among those the Acts were intended to protect.⁶⁶ Courts, however, have regularly relied on such considera-

60. 359 U.S. 65 (1959).

61. 387 U.S. 202 (1967).

62. See *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 75-76 (1959) (Brennan, J., concurring), cited with approval in *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 210 (1967); Landis, *supra* note 38, at 46 n.24.

63. See *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 204 (1967) (optional annuity); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 69 (1959) (variable annuity). See generally Note, *Commingled Trust Funds and Variable Annuities: Uniform Federal Regulation of Investment Funds Operated by Banks and Insurance Companies*, 82 HARV. L. REV. 435 (1968).

64. The Court's approach was made most explicit in Justice Brennan's concurrence in *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 85 (1959) ("In [a variable annuity] sort of operation, examination by state insurance officials to determine the adequacy of reserves and solvency becomes less and less meaningful. The disclosure policy of the Securities Act of 1933 becomes, by comparison, more and more relevant.")

65. 328 U.S. 293, 298-300 (1946). For example, in relating the facts of the case the Court called attention to the similarity between *Howey* investors and those Congress specifically sought to protect. *Id.* at 299-300. More generally, in giving content to the statutory term "investment contract," the Court attempted to arrive at a definition in keeping with the purpose of the Acts. See *id.* at 299. It noted that the term had been used as a catchall for security interests in many state securities laws and that its interpretation by state courts had "crystallized" by 1933 into what is now the *Howey* formula. *Id.* at 298. The Court relied principally on *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 56, 177 N.W. 937, 938 (1920), and on a number of later state court decisions that it interpreted as accepting *Gopher's* analysis. See 328 U.S. at 298 & n.4. But see Long, *supra* note 20, at 155 (*Howey* formula rests on misinterpretation of state court decisions). Because of this crystallization and because the state laws and the federal acts sought to protect the same class, the Court thought it reasonable to adopt the state law standard as the proper test for a security. 328 U.S. at 298-99.

66. See, e.g., *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1126-28 (4th Cir. 1970); *Lynn v. Caraway*, 379 F.2d 934, 945-46 (5th Cir. 1967); *Jung v. K. & D. Mining Co.*, 260 F.2d 607, 609 (7th Cir. 1958); cf. *State v. Hawaii Market Center, Inc.*, 52 Haw. 642, 647, 485 P.2d 105, 108 (1971) (tendency of courts to analyze investment projects mechanically primary weakness of *Howey* formula); Long, *supra* note 20, at 139 (criticizing state courts for applying *Howey* mechanically).

tions to justify a broad reading of *Howey*, thus including within the Acts' coverage investors that the test might otherwise have excluded.⁶⁷

Consideration of the intended beneficiaries of the Acts should be at least as relevant in limiting the Acts' coverage. The Supreme Court implied as much in its most recent security definition case, *United Housing Foundation, Inc. v. Forman*.⁶⁸ The case involved shares in a state-subsidized and state-supervised housing cooperative that entitled their purchasers to lease apartments.⁶⁹ The Court held that the shares were not securities because they failed to fulfill the *Howey* "expectation of profits" requirement.⁷⁰ It argued that "profits" could not be said to attach to the shares because the shares could not be resold at more than original cost and because the financial benefits they afforded their purchasers either could not properly be labeled profits or were likely to be de minimis.⁷¹ In addition, the Court asserted that the prospect of financial benefits had played no part in attracting the shareholders to the cooperative; rather, the shareholders had been in-

67. The *Howey* definition has been repeatedly criticized as too restrictive. See Coffey, *supra* note 24, at 374-76; Hannan & Thomas, *supra* note 18, at 219-20, 236; Long, *supra* note 20, at 177. "Intended class" arguments have been regularly employed to expand its scope. For example, the "risk capital" approach articulated by the California Supreme Court in *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906 (1961), cited in *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 857 n.24 (1975) (sale of recreational interests to finance country club development constituted sale of securities under state securities law), attempts to avoid possible narrow readings of *Howey*'s "profits" requirement. See generally Coffey, *supra* note 24, at 382-84; Hannan & Thomas, *supra* note 18, at 244-49; Long, *supra* note 20, at 164-70. According to the risk capital approach, the Acts were intended to protect investors expecting any benefit of value, not just those expecting "profits" in a monetary sense. The argument is that all persons who risk capital in expectation of some return, regardless of its form, deserve protection.

The element of exclusiveness in *Howey*'s "solely from the efforts of others" requirement has been similarly attacked. Commentators have contended that investors who must themselves make some effort as part of a promotional scheme nevertheless deserve to be protected. See Hannan & Thomas, *supra* note 18, at 249-53. The issue has arisen repeatedly in cases involving franchise agreements. In *SEC v. Glen W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir.), cert. denied, 414 U.S. 821 (1973) ("self-improvement" course franchises), for example, the Ninth Circuit held that in light of the remedial nature of the Acts, the *Howey* "solely" requirement should not be read as a literal limitation on the Acts' scope. The Supreme Court noted the *Turner* view in *United Hous. Foundation, Inc. v. Forman*, 421 U.S. 837, 852 n.16 (1975), but expressly reserved judgment on its merit. The Court did, nevertheless, omit the word "solely" from its purported restatement of the *Howey* test. *Id.* at 852.

68. 421 U.S. 837 (1975).

69. *Id.* at 842-43. An initial question in the case was whether the shares were securities simply because they had been commonly referred to as "stock" since the Acts' definition of security includes the words "any . . . stock." The Court held that nomenclature alone was not determinative. *Id.* at 848-51.

70. *Id.* at 851-60.

71. *Id.* at 851-58. Three supposed sources of "profit" were discussed in the case: tax deductions for the portion of the rent that was applied to pay mortgage interest, savings in rent produced by state subsidies, and earnings from the cooperative's commercial facilities. *Id.* at 855-56.

duced to buy shares solely by the prospect of acquiring a place to live.⁷²

As the dissent pointed out, both conclusions are subject to challenge on the facts. A more accurate characterization of the record is that the shares did hold out a prospect of significant profits and that these profits did, at least to some extent, induce purchases.⁷³ So considered, the shares reasonably satisfied *Howey*, as the dissent argued. What the Court did in order to reach the opposite result was read the facts of the case and the definition of a security in such a way as to take into account the peculiar nature of the *Forman* investors. As the Court maintained without contradiction, the purchasers' overriding motivation was to obtain housing. It follows that they were not making investment decisions of the kind the financial disclosure afforded by the securities laws was intended to inform or, indeed, would be helpful in informing.

Forman and the other cases indicate that courts should limit the coverage of the Acts to contexts in which they may serve their intended beneficiaries. *Daniel* illustrates the need for a more explicit and specific understanding of what those contexts are: one must identify the characteristics of investors, and, to a lesser extent, of the markets in which they invest,⁷⁴ that determine whether the Acts can be used in the way intended. These characteristics are readily discerned.

The "valuation function" of the Acts, that of facilitating intelligent valuation of securities through disclosure, protects investors who make investment decisions that disclosure can inform.⁷⁵ Typically, the investor himself cannot analyze the information disclosed and convert it

72. *Id.* at 851-58.

73. Justice Brennan, in dissent, argued that the financial benefits of the cooperative, although accruing to purchasers as money saved rather than earned, constituted profits covered by the *Howey* test. *Id.* at 861-65; *cf.* Note; *Cooperative Housing Corporations and the Federal Securities Laws*, 71 COLUM. L. REV. 118, 132 (1972) (reaching same conclusion). The record shows that these benefits were not likely to be de minimis and that, as *Howey* requires, they were offered as an inducement to purchasers. Commercial rents alone were likely to exceed \$1 million. The cooperative's bulletin emphasized the reasonable price of the housing, asserted that the project would be managed so as to keep the price low, noted the possibility of rebates, and specifically discussed ownership's tax benefits. *See* 421 U.S. at 853-54; *id.* at 861, 864 (Brennan, J. dissenting).

74. *See* pp. 1682-83 *infra* (importance of efficient markets to intended functioning of Acts). *But cf.* R. JENNINGS & H. MARSH, *supra* note 30, at 856 (argument that 1934 Act does not apply to securities not traded in organized markets has been uniformly rejected by courts). A paradigmatic market, such as the New York Stock Exchange, is not essential to the Acts' intended functioning if investors have resources sufficient to duplicate its principal information processing function. *See* note 77 *infra* (discussing information intermediaries). Investors in the nonmarket securities to which the Acts have usually been applied typically seem to have such resources. *See generally* F. O'NEAL, *CLOSE CORPORATIONS* (2d ed. 1971).

75. *See* 41 SEC ANN. REP. 45 (1975); WHEAT REPORT, *supra* note 45, at 53.

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into a relevant, intelligible and personally usable form.⁷⁶ Instead, he may often be able to employ an intermediary to process the information for him.⁷⁷ More importantly, he can, as the Acts intended, simply rely on the workings of the capital market, which presents him with the investment choice, to reflect expert interpretations of the relevant information in the security's market price.⁷⁸

The Acts' "publicity function"—detering insider misconduct through disclosure—is effective only insofar as insiders realize that what is exposed is subject to careful scrutiny and possible censure.⁷⁹ Although an aggressive SEC could conceivably work to benefit investors in this regard, even if the investors were not able or sufficiently concerned to deter insider misconduct themselves,⁸⁰ this benefit would not have been derived in accordance with the purposes of the Acts. The intent of the Acts was not to establish the SEC in the role of sole or even principal policeman.⁸¹ Indeed the Commission cannot pass formally on the merit or lack of merit of any security.⁸² The deterrent force of disclosure was intended to come from insiders' anticipation of the cumulative reaction of investors, their representative brokers and dealers, and other market experts.⁸³

76. See ADVISORY COMM. ON CORP. DISCLOSURE, SECURITIES AND EXCHANGE COMMISSION REPORT 162-63 (1977) [hereinafter cited as DISCLOSURE REPORT]; Douglas, *Protecting the Investor*, 23 YALE REV. 521, 523-24 (1934); Kripke, *The Myth of the Informed Layman*, 28 BUS. LAW. 631 (1973).

77. See DISCLOSURE REPORT, *supra* note 76, at 162-239 (describing role of "information disseminators"); Douglas, *supra* note 76, at 523-24.

78. See DISCLOSURE REPORT, *supra* note 76, at 313-14; Douglas, *supra* note 76, at 523-24; Fama, *Random Walks in Stock Market Prices*, FINANCIAL ANALYSTS J., Sept./Oct. 1965, at 56.

79. See, e.g., A. BERLE, POWER WITHOUT PROPERTY 110-16 (1959); Cary, *Corporate Standards and Legal Rules*, 50 CALIF. L. REV. 408, 417-18 (1962); Frankfurter, *supra* note 48, at 55; cf. Landau, Merholtz & Perkins, *Protecting a Potential Pensioner's Pension—An Overview of Present and Proposed Law on Trustees' Fiduciary Obligations and Vesting*, 40 BROOKLYN L. REV. 521, 547 (1974) (WPPDA failed because of self-defeating complexity of disclosure).

80. See Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 HASTINGS L.J. 311, 331-36 (1974) (SEC has been able to impose substantive requirements on issuers by use of its discretionary power over registration). *But see* Morton & Booker, *The Paradoxical Nature of Federal Securities Regulations*, 44 DEN. L.J. 479, 494, 497 n.54 (1967) (effectiveness of SEC action depends on attentive investors); cf. Douglas & Bates, *supra* note 37, at 171 (nothing in 1933 Act to control "speculative craze of the American public").

81. See p. 1677 *supra*; cf. J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964) (private enforcement of proxy rules necessary supplement to SEC action).

82. See 1933 Act § 23, 15 U.S.C. § 77w (1970); SEC Rule 425, 17 C.F.R. § 230.425 (1977) (criminal offense to represent that in registering security SEC has passed on its merits); cf. I L. Loss, *supra* note 30, at 184-85 (popular impression that SEC registration constitutes SEC approval hard to dispel).

83. See WHEAT REPORT, *supra* note 45, at 52-53 (describing importance of "filtration process"); Douglas & Bates, *supra* note 37, at 172; Landis, *supra* note 38, at 34-35.

III. The Failure of *Daniel*

Daniel failed to consider whether pension plan participants as a class have the characteristics of the class of investors the securities laws were intended to protect. If the Seventh Circuit had undertaken this inquiry, it would have discovered that pension participants do not display such characteristics. Pension participants would not find useful the Acts' valuation function. Although they might derive some benefit from the Acts' publicity function, the benefit would be neither substantial nor of a kind the Acts intended. Moreover, pension plans are subject to ERISA, a regulatory scheme that comprehensively attends to participant needs, supplies much more effective protections than would the securities laws, and evidences congressional recognition that pension participants are not the type of investors to whom the securities laws were intended to apply.

A. *The Securities Laws and Pension Participants*

The Acts' valuation function serves those investors who make investment choices and have a means of processing the information disclosed. But disclosure would be of no use to pension participants principally because they do not make pension choices. Employees cannot choose their pension plans as investors do shares of stock or mutual funds: particular plans attach to particular jobs or to membership in a particular union.⁸⁴ To select a plan in any meaningful sense, an employee would have to induce his present employer or union to alter its existing plan, substitute a personal plan himself, or make his choice of work or union membership dependent on pension considerations. For reasons other than lack of access to valuation information, employees do not act in any such way,⁸⁵ even to the extent that they find their pensions a matter of concern.⁸⁶ Employer and union recalcitrance would make effecting internal change difficult.⁸⁷ Substitution

84. See generally D. MCGILL, *supra* note 1.

85. See SUBCOMM. ON FISCAL POLICY OF THE JOINT ECONOMIC COMM., 93D CONG., 1ST SESS., THE LABOR MARKET IMPACTS OF THE PRIVATE RETIREMENT SYSTEM 60-72 (Comm. Print 1973) (study by R. Taggart) [hereinafter cited as TAGGART STUDY]; cf. 1941 Hearings, *supra* note 31, at 896-97 (statement of SEC Chairman Purcell) (as practical matter, people do not base job choices on pension considerations).

86. Most employees do not seem greatly concerned about their private pension prospects. M. BERNSTEIN, THE FUTURE OF PRIVATE PENSIONS 13-14 (1964); cf. U.S. BUREAU OF LABOR STATISTICS, DEPT OF LABOR, BULL. No. 1963, EMPLOYEE COMPENSATION IN THE PRIVATE NONFARM ECONOMY, 1974, at 21 (1977) (retirement plan expenditures only 3.7% of total employee compensation) [hereinafter cited as BLS BULL. No. 1963].

87. An employee's pension reform desires are not likely to be shared by his employer or union. See M. BERNSTEIN, *supra* note 86, at 14 (employee/employer conflict over pension terms likely); R. NADER & K. BLACKWELL, *supra* note 3, at 1, 17, 63, 127 (employers and

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of a personal plan would be impossible.⁸⁸ Pension-conscious job switching would be expensive,⁸⁹ often futile,⁹⁰ and, because of the strength and variety of personal interests that assume more importance than pension considerations, unlikely as well.⁹¹

Even if employees did choose their plans, the securities laws' valuation function would be of little use, for most employees would be unable to process the laws' disclosures. Like conventional investors, pension plan participants can only rarely assimilate data of sufficient complexity to allow an accurate valuation of their personal interests.⁹² Unlike conventional investors, pension plan participants cannot expect services to spring up that would be capable of assimilating the data for

unions use pensions plans to serve own interests, which often diverge from those of participants). His means of impressing his desires on his employer or union are limited. The union has, within broad limits, an exclusive right to represent him in collective bargaining situations. See *Emporium Capwell Co. v. Western Addition Community Org.*, 420 U.S. 50, 60-65 (1975). Ratification of collective bargaining agreements by the union membership is not the practice in most unions. See Lahne, *Union Constitutions and Collective Bargaining Procedures*, in *TRADE UNION GOVERNMENT AND COLLECTIVE BARGAINING* 170, 172-74, 181-83, 187 (1970). When ratification is required it usually does not serve as a means by which employees can choose terms and conditions of employment such as pension benefits. Typically the employee is faced with a choice of accepting a generally favorable package or going on strike. Labor Brief, *supra* note 29, at 12 & n.21. See generally H. WELLINGTON, *LABOR AND THE LEGAL PROCESS* 160-61 (1968) (union democracy more myth and aspiration than reality). In any case, it seems likely that the costs of inducing group action, characteristic of collective decisionmaking processes generally, would stifle individual initiative. See generally A. DOWNS, *AN ECONOMIC THEORY OF DEMOCRACY* 260-74 (1957). The Supreme Court has specifically held the Acts' antifraud provisions applicable to one collective action situation, a merger, but only after noting peculiarities of the situation that made securities laws disclosure of individual use. See *SEC v. National Sec., Inc.*, 393 U.S. 453, 466-67 (1969). The Court noted that a shareholder asked to approve a merger may suffer personal injury as a direct result of his personal choice if he is misled: if he votes in favor of the merger and it takes place, he loses his appraisal rights. *Id.* at 467. In a collective bargaining situation, there is no analogous right at stake.

88. See notes 9 & 13 *supra* (*Daniel*-type plans compulsory).

89. Because most plans require participants to satisfy lengthy service requirements before benefit rights vest, changing jobs or unions usually subjects an employee to a substantial reduction or denial of benefits. See *Alabama Power Co. v. Davis*, 431 U.S. 581, 593-94 (1977); Comment, *supra* note 5, at 562-63.

90. In many industries different companies are not likely to offer different pension coverage; a single union's plan may encompass almost the entire industry. See generally M. McDONALD, *RECIPROCITY AMONG PRIVATE MULTIEmployer PENSION PLANS* (1975). In any case, an employee may find that a job that offers preferred coverage is impossible to obtain.

91. Job choice is usually motivated by factors that take precedence over pension considerations. See M. BERNSTEIN, *supra* note 86, at 11, 322 n.5; TAGGART STUDY, *supra* note 85, at 70-72. See generally S. LEVITAN, G. MANGUM & R. MARSHALL, *HUMAN RESOURCES AND LABOR MARKETS* 590-91 (2d ed. 1976); L. REYNOLDS, *THE STRUCTURE OF LABOR MARKETS* 87-112 (1951). This is true for older as well as younger workers. R. TILOVE, *PENSION FUNDS AND ECONOMIC FREEDOM* 28 (A Report to The Fund for the Republic, 1959).

92. See, e.g., R. NADER & K. BLACKWELL, *supra* note 3, at 8, 11; cf. ERISA SENATE REPORT, *supra* note 1, at 4847 (WPPDA disclosure ineffective because incomprehensible to average participant).

them at an acceptably low cost.⁹³ Nor can they rely on an efficient market to incorporate expert interpretations of the information into a price that they could easily use, as conventional investors do, to compare the values of their interests with those of others.⁹⁴ Indeed pension interests are not "bought" and "sold" in markets anything like those the Acts were intended to regulate.⁹⁵

Nor would pension participants as a class benefit to any significant extent (much less in the way intended) from publicity—the second aspect of disclosure. Publicity effectively inhibits insider misconduct only if insiders expect what is exposed to be subjected to public scrutiny and possible censure.⁹⁶ Employees, however, have little reason to give news of pension plan misconduct particular attention. In a defined benefit plan, insider misconduct, like poor investment performance, damages participants only remotely. Unless losses are great enough to cause the failure of the plan and the employer or a lessening of future wage increases, neither of which is likely,⁹⁷ an employee's pension benefits would be unaffected.⁹⁸ Unions, which are themselves often

93. See Clark, *The Soundness of Financial Intermediaries*, 86 YALE L.J. 1, 16-17 (1976). Compare L. REYNOLDS, LABOR ECONOMICS AND LABOR RELATIONS 141-53 (6th ed. 1974) (information flow in labor markets) and B. YAVITZ, D. MORSE & A. DUTKA, THE LABOR MARKET: AN INFORMATION SYSTEM 25-34 (1973) (information intermediaries in labor market) with SECURITIES AND EXCHANGE COMMISSION, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 95, 88th Cong., 1st Sess. pt. 1, at 330-83 (1963) (research and investment advice available to conventional investors). ERISA seems to have provided the only effective pension information intermediary. The statute requires plan administrators to furnish to a participant, upon written request, a statement of the value of his personal interest. ERISA § 105, 29 U.S.C. § 1025 (Supp. V 1975).

94. The imperfections of the market for individual pension capital, to the extent that there can be said to be such a market, and of the labor market generally contrast sharply with the extraordinary efficiency of the capital markets that are regulated by the federal securities laws. L. REYNOLDS, *supra* note 91, at 43. Compare B. MALKIEL, A RANDOM WALK DOWN WALL STREET 170-75 (1973) (efficiency of capital markets) with S. LEVITAN, G. MANGUM & R. MARSHALL, *supra* note 91, at 112-38 (inefficiency of labor markets). See generally Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FINANCE 383 (1970).

95. See H.R. REP. NO. 85, 73d Cong., 1st Sess. 2-3 (1933); note 94 *supra*.

96. See p. 1683 *supra*.

97. See J. BROOKS, CONFLICTS OF INTEREST: CORPORATE PENSION FUND ASSET MANAGEMENT 5 (1975) (disastrous pension plan failures relatively few and rarely result from fiduciary misconduct); BLS BULL. No. 1963, *supra* note 86, at 21 (pension expenditures constitute only slight percentage of total employee compensation).

98. In a defined benefit pension plan the employer bears the risk of insider misconduct and investment performance. The benefits to be received by employees are fixed; employer contributions are adjusted to whatever level is necessary to provide those benefits. See notes 10 & 13 *supra*. In *Daniel*, the Seventh Circuit mistakenly equated the pension plan at issue with a defined contribution plan while discussing its resemblance to mutual funds and variable annuities, both of which are regulated under the Acts. 561 F.2d at 1236-37. In such investments, unlike defined benefit plans, investment performance is one of the most important factors in determining the amount of payout. See Alef & Short, *supra* note 12, at 283-84 (criticizing *Daniel* in this regard). In a defined contribution plan, insider misconduct would directly affect the value of an employee's benefits. See note 10 *supra* (explaining defined contribution mechanism).

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pension-plan insiders and the principal targets of insider misconduct concerns, would not be better policemen.⁹⁹ In addition, there would be no informed and effective reaction of market experts of the kind that serves to protect public corporations because there is no real market for pension interests.¹⁰⁰ Pension participants might nevertheless derive some benefit from the Acts' publicity function, either because of the existence of sanctions for nondisclosure, which might deter some misconduct, or (in a manner not intended by the Acts) as a result of independent efforts by the SEC.¹⁰¹ It seems likely, however, that any such benefit would be quite small.¹⁰² More importantly, such protection would be superfluous, for ERISA already provides more effective deterrents.¹⁰³

B. *The Securities Laws and ERISA*

Consideration of ERISA compels the conclusion that pension plan participants are outside the Acts' intended scope.¹⁰⁴ The Acts have not been applied where other legislation has obviated the need for securi-

99. See, e.g., Note, *At Variance with the Administrative Exemption Procedures of ERISA: A Proposed Reform*, 87 YALE L.J. 760, 763 (1978) (citing recent congressional attention to Teamster and UMW abuses); cf. J. BROOKS, *supra* note 97, at 5 n.* (corporate pension fund abuses differ from union ones more in style than in substance).

100. See p. 1683 *supra* (noting market filtration process); cf. Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607, 610 (1964) (opportunity for fraud increases as market price becomes less representative of security's true value).

101. See p. 1683 & note 80 *supra*; cf. SEC v. Shenker, 424 SEC. REG. & L. REP. (BNA) A-6 (D.D.C., filed Oct. 13, 1977) (SEC injunctive action charging trustees of pension and welfare plan with violating 1933 and 1934 Acts by, among other things, failing to disclose to beneficiaries certain information about loans made by plan), discussed in Sen. Williams Letter, *supra* note 31, at I-4 to I-5 (criticizing *Shenker* consent decree for allowing SEC continuing role in matters extensively regulated by ERISA).

102. Absent attentive investors, even aggressive SEC action is not likely to be very effective. See note 80 *supra*. Moreover it is unlikely that the Commission will be aggressive. An overburdened SEC would probably find it uneconomical to give pension plan filings the kind of thorough review necessary to deter misconduct significantly. See SEC SEC. ACT RELEASE No. 5231 (1972); cf. Cohen, "Truth in Securities" Revisited, 79 HARV. L. REV. 1340, 1362 (1966) (SEC processing of 1934 Act § 12 and § 13 disclosure less effective than processing of registration and proxy disclosure because of former's comparatively greater volume of filings and absence of deadline to speed review). It seems unlikely that Congress, after authorizing 635 new ERISA staff positions in the Department of Labor, would approve a similar pension-related increase in the size of the SEC. Compare U.S. OFFICE OF MANAGEMENT AND BUDGET, THE BUDGET OF THE UNITED STATES, app., 928-29 (1975) (SEC spent \$9.5 million in 1974 to process 12,000 registration and proxy statements, etc.) with 71 PENS. REP. (BNA) R-9 (Feb. 2, 1976) (approximately 500,000 corporate pension plans expected to file with IRS and Department of Labor).

103. See p. 1690 *infra*.

104. ERISA expressly preserves, with certain exceptions, all other applicable federal laws. See ERISA § 514(d), 29 U.S.C. § 1144(d) (Supp. V 1975). However, the Congress that passed this general savings clause did not expect, and would not have wanted, the securities laws to be considered applicable. See, e.g., Sen. Williams Letter, *supra* note 31, at I-4.

ties laws regulation.¹⁰⁵ Pension interests are comprehensively regulated by ERISA.

ERISA limits each of the two major risks that employee pension participants have traditionally faced.¹⁰⁶ First, it contains substantive and procedural provisions designed to ensure the liquidity and solvency of pension plans.¹⁰⁷ Substantively, it establishes strenuous funding rules and fiduciary standards,¹⁰⁸ and a guaranty fund for dealing with plan terminations.¹⁰⁹ Procedurally, it stresses full reports and public disclosure,¹¹⁰ a graduated assortment of remedies (including civil fines),¹¹¹ and ready access to the courts.¹¹² Second, ERISA enables employees to qualify more easily for the benefits sound plans provide. Additional substantive provisions make plan treatment of benefit eligibility pro-

105. Congress has excluded from the Acts' coverage interests to which a specifically tailored scheme of regulation already applied. *See, e.g.*, H.R. REP. No. 85, 73d Cong., 1st Sess. 15 (1933) (insurance); Landis, *supra* note 38, at 44-45 (bank securities). The Court has been careful to avoid needlessly superimposing the Acts on such schemes. *See, e.g.*, SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65, 68 (1959) (construing insurance exemption). The Court's decision in *Tcherepnin v. Knight*, 389 U.S. 332, 332, 335-46 (1967), that withdrawable capital shares in a savings and loan were securities regulated by the Acts, does not demonstrate inattention to this issue, as might be suggested. In contrast with most savings and loan associations, which are subject to extensive federal regulation protective of investors, *see Clark, supra* note 93, at 6 (citing statutes), the association in *Tcherepnin* was not. It had been denied federal insurance of its accounts because of unsafe financial policies and was, indeed, in liquidation at the time of suit. 389 U.S. at 332-34.

106. *See* note 3 *supra* (describing risks).

107. *See generally* Clark, *supra* note 93 (discussing regulation of "soundness" of financial intermediaries, including pension plans).

108. *See* ERISA §§ 301-306, 29 U.S.C. §§ 1081-1086 (Supp. V 1975) (funding rules); *id.* §§ 401-404, 29 U.S.C. §§ 1101-1104 (Supp. V 1975) (fiduciary standards). For a discussion of the Act's funding rules, *see* J. TREYNOR, P. REGAN & W. PRIEST, *THE FINANCIAL REALITY OF PENSION FUNDING UNDER ERISA* (1976). Their principal effect is to transform the legal status of corporate pension liabilities from gratuities into corporate obligations. *Id.* at 27. For a discussion of the Act's fiduciary provisions, *see* Note, *Fiduciary Standards and the Prudent Man Rule Under the Employment [sic] Retirement Income Security Act of 1974*, 88 HARV. L. REV. 960 (1975). In short, the Act establishes a "prudent expert" standard for plan fiduciaries, an "exclusive purpose" rule that is essentially a traditional duty of loyalty, and a system of prohibited transactions. *See* Note, *supra* note 99, at 765-67.

109. *See* ERISA §§ 4001-4009, 4021-4023, 29 U.S.C. §§ 1301-1309, 1321-1323 (Supp. V 1975) (guaranty fund). The Act ensures that employees will, subject to certain limitations, receive accrued benefits. *See generally* Comment, *supra* note 5, at 609-21.

110. *See* ERISA §§ 101-111, 29 U.S.C. §§ 1021-1031 (Supp. V 1975). Under the Act, extensive reports must be made regularly to the Secretary of Labor and more limited but nonetheless comprehensive reports must be automatically furnished to plan participants and beneficiaries. *See generally* Comment, *supra* note 5, at 660-67.

111. *See* ERISA §§ 501, 502, 29 U.S.C. §§ 1131, 1132 (Supp. V 1975) (remedies). Of the statutes regulating financial intermediaries, ERISA has been described as providing the "most complete and most potent set of public and private remedies." Clark, *supra* note 93, at 84; *see id.* at 84 n.241 (describing express remedies); *cf.* Miller & Dorenfeld, *ERISA: Adequate Summary Plan Descriptions*, 14 Hous. L. Rev. 835, 841-49 (1977) (suggesting additional implied remedies).

112. *See* ERISA § 502(a), 29 U.S.C. § 1132(a) (Supp. V 1975) (persons empowered to bring suit). The Act expressly provides for suits by participants, beneficiaries, and the Secretary of Labor. *Id.*

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visions more favorable to employees.¹¹³ The procedural provisions noted above stress comprehensible disclosure of such provisions to participants.¹¹⁴

These provisions, tailored specifically to the needs of pension participants, go far beyond the slight protections offered by the securities laws.¹¹⁵ By reducing relevant differences among pension plans, ERISA makes exercise of pension choice less likely.¹¹⁶ But to the extent that pension participants desire to make such choices, ERISA makes it easier for them to do so effectively. ERISA makes choice less expensive by limiting the penalties plans can impose on job switching.¹¹⁷ It informs such choices by requiring that plan administrators not only disclose information about plan provisions,¹¹⁸ but also furnish

113. See ERISA §§ 202-204, 29 U.S.C. §§ 1052-1054 (Supp. V 1975). In comparison with prior law, the Act makes it much easier for an employee to enter a plan, see *id.* § 202, 29 U.S.C. § 1052 (Supp. V 1975) (minimum participation standards), and receive a nonforfeitable right to substantial benefits, see *id.* § 203, 29 U.S.C. § 1053 (Supp. V 1975) (minimum vesting standards); *id.* § 204, 29 U.S.C. § 1054 (Supp. V 1975) (benefit accrual rules). See generally Comment, *supra* note 5, at 557-88.

114. See note 110 *supra*. In the rules and regulations issued under the Act for reporting and disclosure, the Secretary of Labor has emphasized that material that must be distributed to participants must be written and presented in a manner that will not have the effect of misleading, misinforming, or failing to inform participants and beneficiaries. See 29 C.F.R. § 2520.102 (1977).

115. In *Daniel's* own case, it seems unlikely that disclosure would have prevented his loss of benefits. According to the defendants, *Daniel* received notice of Local 705's benefit eligibility requirements in 1955, 1958, 1969, and 1971. See 410 F. Supp. at 544. Compare *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976) (requiring 1934 Act § 10(b) and Rule 10b-5 plaintiffs to allege scienter) with *B. AARON, supra* note 35, at 120 (1961) ("poor drafting of the plan instrument, inadequate funding, and unwise investment policies are far greater threats to the benefit rights of covered employees than is the dishonest or negligent administration of pension funds") and ERISA SENATE REPORT, *supra* note 1, at 4841-42 (participants lose benefits "not because of some violation of federal law" but because of contractual requirements of plan). Under ERISA, on the other hand, *Daniel's* loss of benefits could not have occurred. His four-month layoff, see note 14 *supra*, would not have been long enough to be considered a break in service sufficient to impede vesting of a right to benefits. See ERISA § 203(b)(2)(A), 29 U.S.C. § 1053(b)(2)(A) (Supp. V 1975). See also *id.* § 203(b)(1), 29 U.S.C. § 1053(b)(1) (Supp. V 1975) (plans must recognize years of service before and after breaks in service); *id.* § 209(a), 29 U.S.C. § 1059(a) (Supp. V 1975) (if employee terminates service or has one year break in service, plan must automatically report to employee regarding benefits due).

116. Investors can be said to base their investment choices on two factors: an investment's expected return and its risk. If two investments share the same expected return and risk an investor will presumably be indifferent as between them. See generally W. SHARPE, PORTFOLIO THEORY AND CAPITAL MARKETS 20-33 (1970). Although ERISA does not dictate plan returns, *i.e.*, benefits, it does substantially limit and thus, to a significant extent, standardize the risk of their nonreceipt, thereby weakening any incentive to make pension choices.

117. See note 113 *supra*. But plans may and still do impose substantial penalty restrictions on employee mobility. See Comment, *supra* note 5, at 586.

118. See note 110 *supra*. In *Daniel*, the Seventh Circuit criticized the substance, timing, and enforcement of ERISA disclosure in comparing it, unfavorably, to that of the securities laws. See 561 F.2d at 1248-49 (reasoning that securities laws would be useful complement to ERISA). The court attacked ERISA for not requiring effective disclosure to

to participants upon written request information about the value of their individual interests.¹¹⁹ Unlike the securities laws, ERISA takes an active approach to preventing fiduciary failures. Instead of relying on the deterrent effect of publicity, ERISA imposes stringent substantive rules expressly directed at insider misconduct.¹²⁰ The rules are enforceable by effective public and private remedies.¹²¹

Most importantly, ERISA and the securities laws are intended to protect different kinds of persons. The two schemes proceed from entirely different principles. The securities laws are directed at ensuring full disclosure of relevant risks; whether to take the risks revealed is the choice of the investor.¹²² ERISA, by contrast, seeks to limit risks.

participants of circumstances (such as Daniel's layoff) that could result in loss of benefits, *see id.* at 1248, for not requiring affirmative disclosure of plan actuarial assumptions, *see id.* at 1248, 1249 & n.58; *cf. id.* at 1229 (in Daniel's plan, assumption could have been that as few as 8% of participants would receive benefits), for permitting waivers of its fiduciary obligations, *see id.* at 1248 n.56, for not requiring its disclosures earlier, *see id.* at 1248-49, and for not expressly creating a general prohibition against false or misleading representations to an employee concerning his pension fund, *see id.* at 1248 n.57.

Each of the court's criticisms was misconceived. ERISA and its regulations specifically require effective disclosure to participants of circumstances which could result in loss of benefits. *See* ERISA § 102(b), 29 U.S.C. § 1022(b) (Supp. V 1975); 29 C.F.R. §§ 2520.102-2(b), 2520.102-3(l) (1977). Disclosure of plan actuarial assumptions would probably be misleading. *See* Cummings, *The Daniel Case—Disclosure or mandatory odd-making?* PENSION WORLD, Nov. 1977, at 39, 41 (assumptions may not reveal average person's probability of forfeiture, much less that of particular individual); *cf.* ERISA § 104(b)(2), 29 U.S.C. § 1024(b)(2) (Supp. V 1975) (participant entitled to such information upon written request). Waivers of ERISA's fiduciary obligations are not permitted. *See id.* § 410(a), 29 U.S.C. § 1110(a) (Supp. V 1975). The timing of ERISA disclosure was intentional. Indeed, Congress specifically rejected a requirement of earlier disclosure similar to that suggested by the court. *Compare* ERISA § 104(b)(1), 29 U.S.C. § 1024(b)(1) (Supp. V 1975) (requiring disclosure within 90 days after employee becomes participant) with H.R. 2, 93d Cong., 2d Sess. § 503(b), 120 CONG. REC. 4995 (1974) (bill first passed by Senate) (requiring disclosure when employee becomes participant). Because the information is meant to allow employees to maintain their eligibility, *see, e.g.*, ERISA SENATE REPORT, *supra* note 1, at 4847, rather than to make an investment decision, *see pp.* 1686-87 *supra* (pension participants do not make securities laws-type investment decisions), more immediate disclosure would be unnecessary. *Cf.* 159 PENS. REP. (BNA) A-16 (Oct. 17, 1977) (according to congressional testimony of SEC Chairman, securities laws satisfied by disclosure 90 days after employment). Finally, although ERISA does not provide express relief for false or misleading representations made outside the context of its formal disclosure system, its system seems sufficiently comprehensive to correct such representations. *See* Comment, *supra* note 5, at 660-63; *cf.* B. AARON, *supra* note 35, at 120 (fraud and negligence comparatively minor threats to pension participants); ERISA SENATE REPORT, *supra* note 1, at 4841-42 (participants lose benefits "not because of some violation of federal law" but because of contractual requirements of plan).

119. *See* ERISA § 105, 29 U.S.C. § 1025 (Supp. V 1975).

120. *See* Note, *supra* note 99, at 765; note 108 *supra* (citing statutory provisions).

121. *See* note 111 *supra*; *cf.* Note, *Public Creditors of Financial Institutions: The Case for a Derivative Right of Action*, 86 YALE L.J. 1422, 1455 (1977) ("most effective method of implementing a derivative right for public creditors would be federal legislation similar to ERISA"). To the extent ERISA's protections prove illusory, Congress has indicated that it will amend the Act's regulatory scheme. *See, e.g.*, PENSION WORLD, Mar. 1977, at 14 (congressmen discuss possible amendments).

122. *See* p. 1677 *supra*.

Retiring *Daniel*

It reflects a judgment that pension participants cannot avoid such risks on their own.¹²³ This difference in approach demonstrates that Congress itself has recognized that pension participants are not within the class of investors the securities laws were intended to protect.

Conclusion

Daniel v. International Brotherhood of Teamsters is an important illustration of the pitfalls of applying the securities laws without due regard for their functional value. In deciding questions of the Acts' general coverage, a context in which legislative intent is likely to be unclear, courts should consider above all whether the class of investors at issue was among the intended beneficiaries of the Acts and would benefit from their coverage. This Note has sketched the means for such consideration. Only if so applied can the Acts be made to serve their proper protective purpose.

123. See, e.g., Clark, *supra* note 93, at 78-79. Professor Clark provides an illustrative comparison. Consider the response of the Acts and ERISA to a perennially important kind of insider misconduct: abuse of power to the detriment of an enterprise in transactions in which an insider has a personal interest. The securities laws can only prompt disclosure of such misconduct. A disgruntled shareholder must then claim under state law the transaction was not "fair"—a determination that in Delaware must be made through litigation. See DEL. CODE ANN. tit. 8, § 144 (Michie 1975). ERISA, on the other hand, attacks such misconduct directly by imposing a general duty of loyalty on pension fund fiduciaries, prohibiting many kinds of transactions with interested parties, listing specific exceptions to the prohibitions, and providing a procedure for regulating permission in special cases. Clark, *supra* note 93, at 78-79; cf. Note, *supra* note 99 (administration of ERISA's prohibited transaction rules overprotective).