Augmenting ERISA with Market Discipline: Transforming Pension Plan Interests into Securities

Keir N. Dougall
University of Michigan Law School

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Private retirement pension plans have grown, during roughly the last one hundred years, from nonexistence to the point where they controlled $1.77 trillion in assets at the end of 1988. The dramatic increase in pension plan participation...
during this period\textsuperscript{4} and the rise in the monetary value of these plans\textsuperscript{5} indicates that many people consider private pension plans to be an important vehicle for retirement savings. Despite the popularity of pension plans, room for improvement still exists.\textsuperscript{6}

Congress passed the Employee Retirement Income Security Act of 1974\textsuperscript{7} (ERISA) to protect pension plan participants and to increase the number of plan participants.\textsuperscript{8} Congress

\textsuperscript{4} Before 1875, pension plans did not exist. See \textit{supra} note 2. As of March 1988, over 48 million civilian workers were covered by some form of pension plan. \textbf{1990 ABSTRACT}, \textit{supra} note 3, at 360 (table no. 590).

\textsuperscript{5} See \textit{supra} note 3 and accompanying text. Courts have recognized the growing influence of pension plans. See, e.g., Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1241 (7th Cir. 1977) ("In the early decades of the 20th century, only 38\% of invested capital was invested indirectly, and of this amount only 1/10 of 1\% was invested in pension funds. By 1962, the indirect sector of the capital markets had jumped to 83\% and pensions constituted 27\% of this amount."), rev'd, 439 U.S. 551 (1979).

\textsuperscript{6} One commentator stated:

Virtually all segments of the employee benefits community have demanded that a national retirement income policy be developed and articulated; that each legislative and regulatory proposal be measured against this policy; that only those proposals that further our national retirement income policy be adopted; and that retirement income security, not revenue-raising, be the focus of congressional debate.

Borzi, \textit{supra} note 1, at 7. Demographic trends indicate that the need for improvement will only grow with time. "In 1980, approximately fifty-six million Americans were in the sixty to seventy age group, with about eighteen million older than seventy. By 2040, these numbers will more than double, rising to 118 million in the sixty to seventy age group with fifty-four million above seventy." \textit{Id.} at 17 (citation omitted).


\textsuperscript{8} See, e.g., 29 U.S.C. § 1001(c) (1988) (declaring that Congress intended to protect pension plan participants at the time of ERISA's enactment). ERISA's legislative history suggests that Congress enacted ERISA "to increase the number of individuals participating in retirement plans." S. REP. NO. 383, 93d Cong., 1st Sess. 1, 1 (1973), \textit{reprinted in} 1974 U.S. CODE CONG. & ADMIN. NEWS 4890, 4890.

Congress passed ERISA for other purposes as well:

In broad outline, the bill [a precursor to ERISA] is designed to:

(1) establish equitable standards of plan administration;

(2) mandate minimum standards of plan design with respect to the vesting of plan benefits;

(3) require minimum standards of fiscal responsibility by requiring the amortization of unfunded liabilities;

(4) insure the vested portion of unfunded liabilities against the risk of premature plan termination; and

(5) promote a renewed expansion of private retirement plans and increase the number of participants receiving private retirement benefits.

enacted ERISA in the context of an existing social security system. ERISA's regulatory scheme, which depends on trust law to monitor pension plan trustees, creates conflicts within pension plan participant subgroups. Such conflicts have been clearly evident in the context of hostile takeovers and social investing.

These conflicts stem from the fundamental structure of pension plans that ERISA envisions. ERISA plans are established as trusts, and plan trustees are required to act for the exclusive benefit of plan "participants and their beneficiaries." Plan trustees often find the exclusive benefit requirement impossible to satisfy because most plan investment decisions, when closely scrutinized, require trustees to choose between the interests of subgroups of plan participants. Under these circumstances, a trustee acts for the benefit of one subgroup of plan participants at the expense of another.

9. "Because social security covers virtually all the private sector work force, most pension plans are designed to supplement social security." Borzi, supra note 1, at 43. Borzi described an individual's retirement income package as "[t]he metaphorical 'three-legged stool' . . . consisting of social security, employer-provided pensions, and individual savings." Id. at 8.


11. ERISA requires periodic reporting and disclosure about pension plans. See 29 U.S.C. §§ 1021-1031 (1988). ERISA's main disclosure provisions require plan administrators to provide plan participants and plan beneficiaries with a summary plan description when they become a participant or beneficiary and every five years thereafter. Id. §§ 1021(a)(1), 1022, 1024(b). Plan administrators also must furnish a summary of the plan's annual report. Id. §§ 1021(a)(2), 1024(b)(3). Upon request, plan administrators must provide plan participants and beneficiaries with information about their plan interests, including the amount of their total accrued benefits. Id. § 1025.

Plan administrators also are required to provide information to the Secretary of Labor. Id. §§ 1002(13), 1021(b). This information includes the summary plan description, a plan description, and annual reports that include financial and actuarial statements. Id. §§ 1021(b), 1023.

In the context of nontransferable pension interests, however, plan participants and beneficiaries have little use for this information. This information has little value because plan participants and beneficiaries cannot transfer their interests between pension plans and can make only limited pension plan investment decisions. See infra Part IV.

12. See infra Parts I & II.
13. See infra Part II.A.
14. See infra Part II.B.
15. See supra note 10.
17. Fischel & Langbein, supra note 10, at 1119-21; see also infra Part I.
Moreover, conflicts can occur between plan participants and shareholders when corporations sponsor pension plans. Corporate plan trustees who are officers of the sponsoring corporation can fail to fulfill their duties to plan participants when they are forced to choose between the interests of employee plan participants and the interests of their corporation and its shareholders.

These specific problems tend to reflect ERISA's more general problems. Not only does ERISA create conflicts within participant subgroups as particular investment decisions are made, but ERISA's limited restraints have led to fears of abuse and a growing lack of confidence even within the highest levels of government. It is not surprising, under

19. See infra Part II.A.
20. The former Administrator of the Labor Department's Office of Pension and Welfare Benefits Programs, Ian Lanoff, stated:

Multiple jurisdiction for the administration of the Employee Retirement Income Security Act of 1974 (ERISA) does not work. Despite eleven years of effort, the Department of Labor (DOL), the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC) do not coordinate their activities effectively when joint action is needed. These deficiencies seriously hamper enforcement and policymaking activities. If ERISA is to be enforced and pension policy is to be made in a rational rather than a haphazard manner, ERISA administration must be consolidated into a single agency.


The New York Times reported that "[p]otential abuse within the nation's $1.7 trillion pension system is a growing concern on Capitol Hill, where both House and Senate panels are looking into the matter. Labor Secretary Elizabeth Hanford Dole has asked Congress to approve funds for an additional 100 agents to police the pensions system." Shortfall in Pension Funds Cited, N.Y. Times, May 9, 1990, at D4, col. 4. "Unfortunately, [Secretary Dole's] proposals will do little to correct the abuse and fraud that experts estimate costs [sic] the system more than $4 billion a year," Bernstein, Plan to Regulate Pension Funds Isn't Adequate, L.A. Times, June 26, 1990, at D3, col. 1. Currently, "fewer than 1 percent of the 900,000 private pension plans covered by [ERISA] 'receive even passing scrutiny' from the government in any given year." Swoboda, Pension Fund Called Vulnerable: Official Says Deficit Could Hit $8 Billion, Washington Post, June 14, 1990, at C1, col. 2, C7, col. 1 (discussing the testimony of Ray Maria, deputy inspector general of the Department of Labor). In 1989, the Labor Department's Office of Inspector General warned "that lax enforcement of federal pension laws could make the nation's private retirement system the next major government cleanup program, similar to the one in the savings and loan industry." Id. at C1, col. 2. "An unknown portion of the $1.6 trillion in assets that are currently in private pension plans likewise may be at risk . . . . Unless steps are taken now, today's S&L bail-out may become tomorrow's ERISA nightmare." Office of Inspector Gen., U.S. Dep't of Labor, Semiannual Report 3 (1989); see also infra notes 195-98 and accompanying text. But one commentator disagrees:

Unlike the S&L mess, the consensus is that there's little systematic fraud in the pension system, especially with underfunded plans. In addition, pension-
ERISA’s current structure, to hear that “[t]he private pension system, which for years has been a major source of retirement protection as well as investment capital for the economy, is in decline as workers and employers turn to other savings vehicles.” Relying on ERISA alone, in this environment, is imprudent.

ERISA also leaves a large number of employees without any pension plan coverage. The first step in distributing more broadly the benefits of retirement savings through pension plans must be to increase the availability of pension plans that inspire confidence among plan participants.

Courts have strained to minimize problems under ERISA’s pension plan governance structure by giving the language of the statute an innovative interpretation. Commentators

fund managers invest conservatively. A mere 1% to 3% of pension-fund assets wound up invested in “junk” bonds.

“The S&L industry had people willing to commit fraud and engage in criminal conduct,” PBGC Executive Director James B. Lockhart said in a recent speech. “Major pensions have almost no such people.”

Benham, Does Nation’s Pension System Threaten Another Bailout?, Investor’s Daily, Apr. 12, 1990, at 10, col. 1. The Department of Labor continues to express concern over pension law enforcement. This spring Labor Secretary Lynn Martin said that “in a relatively short time,’ she will deal with issues involving pension plan enforcement.”


22. See infra notes 195-98 and accompanying text.

23. Approximately 48 million civilian workers, which represent only 40.8% of all civilian workers, were covered by pension plans as of March 1988. 1990 ABSTRACT, supra note 3, at 360 (table no. 590). Simple math reveals that almost 70 million civilian workers, representing the remaining 59.2% of such workers, were not covered.

24. See generally Borzi, supra note 1, at 23-30. In her call for a national retirement income policy, Borzi states, “[Congress] should consider how to increase pension coverage [and] increase eligibility for plan participation . . . .” Id. at 22-23. Congress, of course, has been very concerned with protecting the interests of pension plan participants. See supra note 8 and accompanying text. Adequate protection will inspire confidence.

25. In Donovan v. Bierwirth, 680 F.2d 263 (2d Cir.), cert. denied, 459 U.S. 1069 (1982), Judge Friendly was called upon to reconcile the provision of ERISA that requires pension plan trustees to act for the exclusive benefit of plan participants with the provision that allows plan trustees to serve simultaneously as officers of the sponsoring corporation. He stated that even if a trustee’s action incidentally benefits the sponsoring corporation, the trustee will not violate ERISA’s exclusive benefit rule if the action is “made with an eye single to the interests of the participants and beneficiaries [of the plan].” Id. at 271. Judge Friendly, in dictum, agreed with the trustees that the “exclusive benefit of the plan beneficiaries” could, in some instances, permit the trustees to act for the exclusive benefit of plan beneficiaries and the company plan sponsor. Id. at 271-73. This interpretation appears to be a strained
have pressed for adjustments in the definition of a trustee's fiduciary duties. 26 These approaches to solving problems under ERISA are inherently limited because they rely solely upon courts and a federal insurance program to guarantee the welfare of plan participants. 27

To provide needed monitoring and disciplining of pension plan trustees, market forces should be used to augment trust law in governing pension plans. By transforming pension plan interests into transferable securities and by developing a market for such interests, the securities laws and the forces of competition would discipline plan trustees, augmenting the duties imposed by trust law. 28 Such a pension plan interest would resemble a transferable interest in a mutual fund.

Plan participants would not need to rely exclusively on courts to redress grievances with plan trustees because they would be able to transfer their interests out of a given pension plan when they disagree with their trustee's investment strategy. This approach would effect a significant change from current practice because a participant's pension investment decision would be completely independent of a participant's employer or decision to change jobs. 29 Congress should enact reforms that supplement ERISA's trust law with market forces to foster popular confidence in the pension system and to deter abuse by pension plan trustees. Congress should transform pension plan interests into securities.

Part I of this Note provides general background information about pension plans and details the problems that ERISA creates because of its dependence on trust law. Part II canvasses recent problems in pension plan governance that courts and pension plan members have faced in takeover defense and social investment contexts, demonstrating that

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reading of ERISA. See Fischel & Langbein, supra note 10, at 1127-28 (criticizing Bierwirth's focus on incidental benefits in the interpretation of ERISA's exclusive benefit rule).

26. Professors Fischel and Langbein argue that a trustee's fiduciary duty to act for the exclusive benefit of plan members should include a duty of impartiality. Fischel & Langbein, supra note 10, at 1107.

27. ERISA provides for criminal penalties and civil enforcement of its provisions. 29 U.S.C. §§ 1131-1132 (1988). Civil actions may be brought by plan participants, plan beneficiaries, fiduciaries, or the Secretary of Labor. Id. § 1132(a). In addition, ERISA provides for the establishment of the Pension Benefit Guaranty Corporation (PBGC), which insures some pension plan participants from losses. Id. §§ 1301-1371.

28. See infra Part IV.

29. See infra note 104.
ERISA's use of trust law cannot respond adequately to these problems. Parts I and II draw on an analysis of ERISA presented by Professors Fischel and Langbein, but argue that their proposals for changing ERISA inadequately address the problems they identify. Part III argues that the economic realities of the pension plan transaction support the conclusion that an interest in a pension plan is a security. Part IV describes the advantages that will flow from applying the securities laws to all pension plan interests and from using a market in pension plan interests as a monitoring tool. Part IV argues that the advantages of such an approach to pension interests would outweigh its costs.

I. ERISA PLANS, PARTICIPANTS, AND SUBGROUPS

Pension plans are financial arrangements under which employees can defer present income in favor of retirement benefits. Most plan participants belong to corporate plans. Pension plans may be either defined-benefit plans or defined-contribution plans. A defined-benefit plan guarantees a fixed level of benefits to plan members.

30. See Fischel & Langbein, supra note 10.
31. Id. at 1111 ("A pension plan envisions a program of savings during the worker's period of employment, followed by distribution to the worker and his spouse during their retirement. Such a program may endure for decades."). The Securities and Exchange Commission (SEC) gives this definition:

[An employee benefit plan is] a pension, profit-sharing, or similar plan. It does not include welfare and similar plans which provide for hospitalization or disability benefits, funeral expenses, or social or cultural activities. These latter plans historically have not been considered subject to the securities laws because they do not involve any expectation of financial return on the employee's part.


32. "Perhaps the largest single category of plans in terms of the number of participants are so-called 'corporate' plans . . . . Such plans all share the common characteristic of being established by corporations." Release No. 33-6188, supra note 31, at 8964.

33. 29 U.S.C. § 1002(34)-(35) (1988). See also 2 L. LOSS & J. SELIGMAN, SECURITIES REGULATION 1031 (3d ed. 1989) ("In a broad sense, all employee benefit plans can be reduced to two basic categories: defined benefit plans and defined contribution plans.") (footnote omitted).

34. 29 U.S.C. § 1002(35) (1988) (providing a technical definition of defined-benefit plan); see also 2 L. LOSS & J. SELIGMAN, supra note 33, at 1031 ("A defined benefit plan pays fixed or determinable benefits."); Fischel & Langbein, supra note 10, at 1112.
Defined-benefit plans accumulate assets for retirement benefits from two sources. First, a defined-benefit plan acquires assets through contributions by participants or their employers into the plan.\textsuperscript{35} Second, the assets of a defined-benefit plan are invested for profit by the plan trustee.\textsuperscript{36} If the yield from defined-benefit plan investments does not provide sufficient income to meet plan obligations, additional contributions to the plan will be required.\textsuperscript{37}

Inaccurate actuarial estimation may lead to overfunding or underfunding of defined-benefit plans because trustees of defined-benefit plans rely on actuarial analysis to determine the level of contributions required to fund future benefits.\textsuperscript{38} An important characteristic of the defined-benefit plan is that the plan sponsor, usually the employer, bears the risk of poor investment decisions.\textsuperscript{39} Title IV of ERISA created the Pension Benefit Guaranty Corporation (PBGC)\textsuperscript{40} to insure most

\begin{itemize}
\item \textsuperscript{35} 2 L. LOSS \& J. SELIGMAN, supra note 33, at 1032 ("Both defined benefit and defined contribution plans can provide for employee contributions, and thus be contributory, or rely solely on employer contributions and be noncontributory.").
\item \textsuperscript{36} In International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979), the Court discussed a defined-benefit plan (the "Fund") established through a collective bargaining agreement. \textit{Id.} at 554 \& n.3. The Court stated: It is true that the Fund, like other holders of large assets, depends to some extent on earnings from its assets. In the case of a pension fund, however, a far larger portion of its income comes from employer contributions, a source in no way dependent on the efforts of the Fund's managers. \textit{Id.} at 561-62.
\item \textsuperscript{37} The SEC described the operation of defined-benefit plans this way: The benefits ordinarily are described in a formula which specifies the amount payable in monthly or annual installments to participants who retire at a certain age. As long as the plan and the employer(s) contributing to the plan remain solvent, and the plan continues to be operated, vested participants will receive the benefits specified. In the event the investment results of the plan do not meet expectations, the employer(s) usually will be required, on the basis of actuarial computations, to make additional contributions to fund the promised benefits. Release No. 33-6188, supra note 31, at 8963 (footnotes omitted).
\item \textsuperscript{38} Fischel \& Langbein, supra note 10, at 1149.
\item \textsuperscript{39} As Professors Fischel and Langbein explain: Under a defined benefit plan, the employer bears the investment risk. Since the employer has promised to provide benefits at a certain level, the employer remains liable to pay the benefits even if the fund turns up short. By the same token, when investments yield unexpectedly high returns, the employer's liability to contribute to the plan is correspondingly reduced. \textit{Id.} at 1112-13.
defined-benefit plan participants against the inability of a corporate sponsor to make required contributions to the plan. Defined-benefit plan sponsors pay a premium for the PBGC's insurance. In other words, if because of poor investments a defined-benefit plan is underfunded when benefits become due, the corporate sponsor or the PBGC must satisfy the deficiency.

By contrast, participants in a defined-contribution plan bear the risk of poor investment decisions. Defined-contribution plans are similar to defined-benefit plans because they also accumulate assets for retirement benefits through contributions to the plan and through the investment of plan assets.

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41. 29 U.S.C. §§ 1302(a), 1321 (1988). Section 1302(a) describes Congress's purposes in creating the PBGC. One of those purposes was "to provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under plans to which this subchapter applies." Id. § 1302(a)(2). Section 1321(a) establishes broad PBGC insurance coverage of pension plans subject to the limitations of § 1321(b): "Except as provided in subsection (b) of this section, this section applies to any plan . . . ." Id. § 1321(a). Section 1321(b) carves out exceptions to the broad coverage language of § 1321(a), the most important of which is the exception for defined-contribution plans. Defined-contribution plans are not insured by the PBGC. Id. § 1321(b) ("This section does not apply to any plan—(1) which is an individual account plan [(a defined-contribution plan)], as defined in paragraph (34) of section 1002 of this title . . . ."); see also Klimkowsky & Lanoff, supra note 20, at 89 n.2 ("Title IV of ERISA creates the PBGC as an independent corporation within the Department of Labor that is charged with administering the termination insurance program for defined benefit plans."); Note, Who Should Pay When Federally Insured Pension Funds Go Broke?: A Strategy for Recovering from Wrongdoers, 65 NOTRE DAME L. REV. 308, 311 & n.15 (1988) (authored by J. Robert Sufioleta, Jr.).

42. 29 U.S.C. § 1322 (1988) (defining the types of benefits the PBGC guarantees); see also Note, supra note 41, at 311-13 ("As a federal insurance program, the PBGC functions much like a private insurance company. The PBGC collects premiums from all of its customers to pay for the failure of a relatively small number of pension programs.") (footnote omitted).


44. See supra note 39.

45. See Release No. 33-6188, supra note 41, at 8966.

46. ERISA gives this definition: [A defined-contribution plan is] a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

Defined-contribution plan participants reap a pro rata share in profits that the plan realizes.\textsuperscript{48} The PBGC does not, however, insure defined-contribution plans.\textsuperscript{49} A defined-contribution plan does not guarantee profits, which places the risk of poor plan investments on the shoulders of plan participants.\textsuperscript{50} Although the distinction between defined-benefit and defined-contribution plans is important, it is not the only distinguishing characteristic of pension plans.

The United States Supreme Court and the Securities and Exchange Commission (SEC) have focused on two additional factors when analyzing pension plans. The first factor is whether a given plan is "voluntary" or "compulsory."\textsuperscript{51} The Court defined a compulsory plan as one where "[e]mployees had no choice as to participation in the plan, and did not have the option of demanding that the employer's contribution be paid directly to them as a substitute for pension eligibility."\textsuperscript{52} The second factor is whether a given plan is "contributory" or "noncontributory."\textsuperscript{53} The Court defined a noncontributory plan as one in which the participants' employer made all contributions to the plan for the participants and in which "employees paid nothing to the plan themselves."\textsuperscript{54} Currently, corporate plan sponsors may establish both defined-benefit and defined-contribution plans so that participation in a given plan is either voluntary or compulsory.\textsuperscript{55} Similarly, sponsors may establish both defined-benefit and defined-contribution plans as either contributory or noncontributory.\textsuperscript{56}

\textsuperscript{48} See id. "[D]efined contribution plans maintain individual accounts for all participating employees. These accounts reflect each participant's share in the underlying trust assets and are adjusted annually to take into account plan contributions, earnings and forfeitures." Release No. 33-6188, supra note 31, at 8963 (footnote omitted); see also 2 L. LOSS & J. SELIGMAN, supra note 33, at 1032 ("[A] defined contribution plan does not guarantee a fixed amount of benefits. Rather, benefits vary depending on such factors as the amount of plan contributions and the investment success of the plan.") (footnote omitted).

\textsuperscript{49} 29 U.S.C. § 1321 (b)(1) (1988); see supra note 41.

\textsuperscript{50} See supra note 46 and accompanying text.


\textsuperscript{52} Daniel, 439 U.S. at 553.

\textsuperscript{53} See id.; see also Release No. 33-6188, supra note 31, at 8964-65.

\textsuperscript{54} Daniel, 439 U.S. at 553.

\textsuperscript{55} 2 L. LOSS & J. SELIGMAN, supra note 33, at 1032.

\textsuperscript{56} See id.; see also Release No. 33-6188, supra note 31, at 8963 ("Both defined benefit and defined contribution plans can provide for employee contributions.").
In addition, when sponsors establish pension plans they may choose to designate one of their officers as the plan trustee. ERISA trustees are required to act "for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries ...." Although the exclusive benefit requirement would seem to be adequate, in theory, for the protection of participants, it has proved insufficient in practice. Professors Fischel and Langbein note that there are many interested constituencies within any group of pension plan participants. When the interests of these constituencies or plan subgroups diverge, the plan trustee faces the difficult task of acting for the exclusive benefit of the different plan subgroups.

At least three easily identifiable subgroups comprise the participants of virtually every pension plan: young employees, employees close to retirement, and retired beneficiaries. Each group places a different value on its expected stream of future retirement payments. The relative value of current income to deferred retirement income is higher for new employees than for employees close to retirement. The income stream from a current job typically accounts for the largest part of the assets of young employees, who will retire in the distant future. A young employee's retirement benefits, when discounted to present value, comprise a small fraction of her current assets. Using a similar analysis, employees closer to retirement would consider their retirement benefits to be a larger percentage of their total assets. These different participant subgroups, which place different values

57. 29 U.S.C. § 1108(c)(3) (1988); see also Fischel & Langbein, supra note 10, at 1126-28 (arguing that because the employer bears the risk of bad investment decisions in defined-benefit plans, allowing the trustee of the plan to be a corporate officer is reasonable).
59. See infra Part II.
60. Fischel & Langbein, supra note 10, at 1119-22.
61. See id. at 1120-21.
62. See id.
63. Professor Coffee states:

[The manager's most important asset is his or her job. Although the manager generally does not have a recognized property right in his [or her] employment relationship with the corporation, this relationship still has a present value to the manager equal to the discounted earnings stream he or she expects to receive from that job (or career path) until retirement.

64. Fischel & Langbein, supra note 10, at 1120.
on current jobs and retirement benefits, cannot be expected to view a given investment decision with unanimity.

A particular investment decision may divide plan beneficiaries along other lines. For instance, a plan trustee might be forced to decide whether to invest in the securities of a profitable corporation that is a notorious polluter. Although one might expect participants closer to retirement to favor maximizing profits, they can be expected to divide along lines not necessarily dependent upon age concerning the question of whether to maximize plan profits at a potential cost to the environment. The interests of plan participants concerned with the environment are sacrificed by the plan trustee who chooses to favor profit maximization by investing in the polluter. A trustee who must act for the exclusive benefit of plan participants faces the impossible dilemma of trying to satisfy all plan members when an investment decision necessarily will favor one participant subgroup over another. Although this flaw in ERISA's governance structure can arise in every investment decision, it surfaces most starkly where decisions involve social investment and takeover defenses. Conflicts between plan participant subgroups will be abated if pension plan interests are readily transferable.

II. CONFLICTS BETWEEN ERISA PLAN PARTICIPANTS

ERISA's pervasive regulatory scheme, which depends on trust law to monitor pension plan trustees, creates conflicts within plan participant subgroups in corporate takeover defense and social investing contexts. Although these contexts bring participant conflicts into high relief, any plan asset investment decision by a trustee can create conflicts.

A. The Pension Plan Takeover Defense

Diversion of pension plan assets to fend off a hostile corporate takeover has generated conflicts within subgroups of plan participants.

65. See infra Part II.B.
66. See supra Part I.
In Donovan v. Bierwirth, the management of the Grumman Corporation was confronted with a hostile tender offer from the LTV Corporation and Grumman's management took defensive measures. Immediately prior to the takeover attempt, the Grumman Corporation Pension Plan held 525,000 shares of Grumman stock valued at roughly twenty-five dollars per share. LTV's tender offer was for up to seventy percent of Grumman stock at forty-five dollars per share. The trustees of the Grumman Corporation Pension Plan were the chairman of Grumman's board of directors, its chief financial officer, and the treasurer of Grumman Aerospace. The Grumman Pension Plan trustees helped to fend off LTV's hostile tender offer by voting not to tender the Grumman Pension Plan's Grumman stock and by causing the Grumman Pension Plan to purchase large blocks of the stock. The Plan purchased Grumman stock at inflated prices during the battle for corporate control and suffered substantial losses when the takeover attempt was defeated. The newly purchased stock plummeted to its pretakeover value when the speculation surrounding LTV's tender offer ended.

Bierwirth involved a defined-benefit plan. Professors Fischel and Langbein point out that if a defined-benefit plan trustee defends against a hostile takeover, the interests of younger plan participants and shareholders will be sacrificed,

67. See generally Fischel & Langbein, supra note 10, at 1138-43.
69. Bierwirth, 680 F.2d at 266-67. The Grumman Board decided to oppose the LTV offer after Dillon, Read & Co., opined that the offer was inadequate. Id. at 266. Defensive measures taken after a hostile tender offer are not uncommon. Rosenzweig notes that a target's management often will sue a raider in an attempt to fend off a tender offer. Rosenzweig, Target Litigation, 85 Mich. L. Rev. 110, 111 (1986).
70. Bierwirth, 680 F.2d at 266-67.
71. Id. at 265-66.
72. Id. at 265, 267. Grumman Aerospace was a subsidiary of the Grumman Corporation at the time. Bierwirth, 538 F. Supp. at 466.
73. Bierwirth, 680 F.2d at 268.
74. Id. at 269.
75. Id. at 268-69. The Grumman Plan purchased over 1.1 million shares of Grumman stock in October 1981 at prices ranging between $36.62 and $38.61, raising the Plan's holdings from just under 4% to roughly 8% of Grumman's outstanding shares. Id. at 269. The LTV hostile takeover attempt failed. Fischel & Langbein, supra note 10, at 1139. When the Second Circuit rendered its opinion in May 1982, Grumman stock was trading at just over $26 per share, close to its preoffer price. Bierwirth, 680 F.2d at 269.
76. Bierwirth, 680 F.2d at 267.
and if a defined-contribution plan trustee uses the defense, older plan participants' interests will be sacrificed.  

After a successful pension plan takeover defense, the defending plan will likely suffer an immediate loss of funds for payment to retirees. Beneficiaries (typically older retirees) of defined-benefit plans, however, will not experience a diminution in plan benefits after a successful takeover defense because the employer has guaranteed that a defined benefit will be paid to them. The employer and its shareholders will be forced to use their own resources to make up the shortfall in plan assets. These are resources that could have been used to develop corporate opportunities, pay dividends, and generate new jobs for current employees. Therefore, if a defined-benefit plan is used to defend against a hostile takeover, the interests of younger employee-participants and shareholders are sacrificed for the benefit of older employee-participants and retirees.

77. See Fischel & Langbein, supra note 10, at 1140-41.

78. A pension plan that successfully thwarts an attempted takeover of its sponsoring corporation by purchasing its sponsor's shares at the high prices induced by the tender offer will likely lose money because the price of the newly purchased shares will fall when the takeover attempt is defeated.

The best available data show that if a firm fends off a bid, its profits decline, and its stock price (adjusted for inflation and market-wide changes) never tops the initial bid, even if it is later acquired by another firm. Stock of firms adopting poison pills falls in price, as does the stock of firms that adopt most kinds of anti-takeover amendments to their articles of incorporation.


79. See supra notes 37-45 and accompanying text; see also Fischel & Langbein, supra note 10, at 1140 (discussing injury to Grumman shareholders from the loss incurred by the Grumman defined-benefit plan).

80. There is anecdotal evidence that the Grumman Pension Plan participants in Bierwirth were divided over the issue of the trustees' takeover defense decision and the use of plan assets for that end. The Bierwirth court states:

[A] supporting affidavit of one of the Plan participants alleged that: [S]pontaneously and within days after this suit was commenced, Grumman employees at all levels and in all departments began to circulate petitions expressing their approval of the trustees’ actions, as participants in the Pension Plan. To date, petitions have been signed by approximately 17,000 of the 22,000 employees who are plan participants and beneficiaries.

Bierwirth, 680 F.2d at 265. Of course, it is not possible to determine why those 17,000 employees who signed the petition were in favor of the trustees’ actions from the statement of the Bierwirth court alone. What is clear, however, is that 5,000 employees did not sign the petition. Whatever their reasons were, it is plausible to assume that some number of those 5,000 were opposed to the trustees’ actions. It thus seems apparent that the Bierwirth plan participants were divided on the issue of the trustees’ decision.
Similarly, a defined-contribution plan will suffer an immediate loss of funds if the trustee's takeover defense is successful. Beneficiaries of defined-contribution plans will suffer a diminution in retirement benefits because they bear the risk of plan losses. The defined-contribution plan trustee's decision to defend against a takeover decision indirectly transfers wealth from older employees and retirees to newer employees and shareholders. This transfer occurs because the pension plan's assets, as opposed to the corporate assets of shareholders, are spent to thwart the takeover and to maintain present jobs rather than to provide retirement benefits.

At least one court has explicitly recognized that an investment decision by a defined-contribution plan trustee creates conflicts within subgroups of plan participants. The court concluded that the best solution was for the trustee to act in a neutral manner and in "the best interests of beneficiaries in the abstract as beneficiaries." Under this standard, a plan
trustee theoretically could act in such a way as to leave all participants discontented without violating ERISA.

Commentators have argued that when corporate pension plan trustees purchase or sell target shares during a contested tender offer, their actions should be scrutinized and found to violate ERISA if they are motivated by something other than the interests of the plan’s participants. When corporate officials also serve as pension plan trustees, special conflicts are created. Particularly during a takeover attempt, such trustees may be tempted to use plan assets to provide a benefit to either themselves or the target corporation management rather than plan participants. Although this conflict of interest may be very real, Fischel and Langbein’s analysis requires a more searching inquiry. Enjoining a plan trustee in a takeover context necessarily means choosing the interests of one plan participant subgroup over another. In Bierwirth, the court declined to adopt a per se rule against a corporate trustee who invests pension assets during a takeover contest, but did hold the Grumman corporate trustees liable for a breach of ERISA’s exclusive benefit rule.

86. See, e.g., Comment, Making a Prudent Response to a Tender Offer: The Corporation Trustee’s Dilemma Under ERISA, 32 AM. U.L. REV. 839, 842 (1983) (authored by Elizabeth J. Buck) (arguing that “it is virtually impossible for corporation trustees to satisfy ERISA’s fiduciary standards when they use pension plan assets to defeat a hostile takeover”); Note, The Duties of Employee Benefit Plan Trustees Under ERISA in Hostile Tender Offers, 82 COLUM. L. REV. 1692, 1719 (1982) (authored by Frank M. Cappuccio) (arguing that “during a tender offer, trustees who are also officers of the target should be uniformly barred from purchasing the target’s securities with plan assets”); cf. Junewicz, The Appropriate Limits of Section 14(e) of the Securities Exchange Act of 1934, 62 TEX. L. REV. 1171, 1202 & n.205 (1984) (arguing that purchasing target stock for entrenchment purposes violates the securities laws and ERISA).

87. Comment, supra note 86, at 840.

88. A rule preventing defined-contribution plan assets from being used to place target stock in friendly plan hands during a hostile takeover defense favors older employees and beneficiaries. The defined-contribution plan would not be allowed to risk the losses that surround a successful takeover defense. Because older employees value their benefits more than younger employees, they should be less willing to sacrifice assets for future benefits in order to spare current jobs.

A rule preventing defined-benefit plan assets from being used to place target stock in friendly plan hands during a hostile takeover defense favors shareholders and younger employee-participants. The defined-benefit plan would not be allowed to risk the losses that surround a successful takeover defense. Defined-benefit plan losses must be replaced with corporate assets. Thus, no corporate assets that could inure to the benefit of shareholders or younger employees would be required to make up the losses prevented by the rule.

B. The Social Investment of Pension Plan Assets

Using pension assets for "social investment" purposes presents issues similar to those raised in the takeover defense situation because conflicts between plan participants also occur in this context.90 The social investment of pension assets involves investing that is based on more than purely economic factors.91 Pension plan investment policies involving questions of social investing may be divided into two categories: "socially sensitive investment policies,"92 and "socially dictated investment policies."93 Commentators generally have concluded that although socially sensitive policies may survive scrutiny under ERISA, socially dictated policies are unlikely to survive that scrutiny.94

90. See generally Fischel & Langbein, supra note 10, at 1143-49.
92. Hutchinson & Cole, supra note 91, at 1345 (“‘Socially sensitive investment policies’ include those investment practices in which the investing fiduciary analyzes traditional investment considerations such as plan characteristics, risk/return factors, liquidity, and diversification. Once this analysis is completed, however, the fiduciary then selects among financially comparable investment alternatives by considering other factors.”).
93. Id. at 1346 (“‘Socially dictated investment policies’ are those investment practices and policies which either (1) permit the sacrifice of safety, return, diversification, or marketability; or (2) are undertaken to serve some objective that cannot be related to the interests of plan participants and beneficiaries in their capacity as such.”).
94. See, e.g., id. at 1388 (“Although there appears to be some room within the legal framework of the statute for socially sensitive investment policies intended to promote the retirement interests of beneficiaries, ERISA appears to proscribe policies sacrificing financial comparability or promoting the interests of third parties in pursuit of some broader social objective.”); Lanoff, supra note 91, at 390 (“If, after evaluating other factors, two investments appear to be equally desirable, then social judgments are permissible in determining which to select. The point is that social judgments may not properly be substituted for any factors which would otherwise be considered in a given case.”); Professors Langbein & Posner argue: (S)ocial investing is undesirable because it appears to reduce the overall utility, however broadly defined, of the investment beneficiaries. It remains to consider
Using Fischel and Langbein's analysis, conflicts between plan participant subgroups can be expected when a plan trustee makes either a socially sensitive or a socially dictated investment decision. Although conflicts over socially sensitive investments might arguably be less pronounced because the trustee has made an "economically comparable" investment, plan participants can be expected to disagree over how important a given social issue is or over how to allocate limited pension assets between more than one socially sensitive investment.

Conflicts between plan participants over a socially dictated investment should be more pronounced because the investment will likely incur a quantifiable loss. This investment decision may confer a benefit on those plan participants who approve of the social policy. If the investment is made by a defined-contribution plan, those plan participants who oppose the social policy will bear the downside risk of plan investments with no corresponding benefit. If a defined-benefit plan makes a socially-dictated investment, shareholders and younger-employee plan participants who oppose the social policy will be affected adversely because the corporate plan sponsor bears the risk of investment losses. Once again, the trustee who is required

whether social investing is contrary to trust law and its statutory counterparts. We conclude that it is . . . ; a trustee who sacrifices the beneficiary's financial well-being for any other object breaches both his duty of loyalty to the beneficiary and his duty of prudence in investment. Langbein & Posner, supra note 91, at 96. But see Ravikoff & Curzan, supra note 91, at 546 ("Although the law has not settled on any particular interpretation, there is ample reason to believe that courts will ultimately give trustees considerable freedom to foster nontraditional goals.").

95. Some socially dictated investment decisions also will provide monetary benefits. See Withers v. Teachers' Retirement Sys., 447 F. Supp. 1248, 1259 (S.D.N.Y. 1978) (holding that a New York City teachers' pension plan's decision to buy speculative New York City bonds to avert the city's bankruptcy did not violate state law because the investment decision benefited all plan participants), aff'd, 595 F.2d 1210 (2d Cir. 1979).

Other socially dictated investment decisions arguably will benefit only some participants spiritually and none monetarily. See generally Troyer, Slocombe & Boisture, Divestment of South Africa Investments: The Legal Implications for Foundations, Other Charitable Institutions, and Pension Funds, 74 GEO. L.J. 127 (1985). I believe that even a purely spiritual benefit has value for those plan participants who agree with the socially-dictated investment decision.

96. See supra notes 46-50 and accompanying text.

97. Fischel & Langbein, supra note 10, at 1144. The use of corporate assets to make up shortfalls from a less economically rewarding social investment adversely affects younger employees who are plan participants and oppose the social policy
under ERISA to act for the exclusive benefit of all plan participants and their beneficiaries must choose between plan participant subgroups when making a social investment decision.

Fischel and Langbein suggest that courts should recognize an implied duty of impartiality for pension plan trustees. In situations like pension plan takeover defenses and social investments, trustees would be required to choose impartially between the differing interests of plan participant subgroups. At first glance, invoking the rubric of impartiality seems laudable. Nevertheless, under the impartiality rule, some subgroup of plan participants will always lose. The impartial trustee is forced to choose one participant subgroup over another. I doubt that a trustee will display the wisdom of King Solomon when making these choices.

In addition, one wonders whether corporate trustees will be any more impartial when considering the interests of different subgroups of plan participants than they have been when choosing between their own interests and those of participants as a whole. In short, corporate trustees might invariably decide on an “impartial” basis that the interests of the subgroup that will benefit from a successful takeover defense are more important than the interests of the other plan participants because of the trustee’s strong personal interest in seeing the takeover thwarted. Fischel and Langbein’s analysis of the problems associated with the fiduciary duties of pension plan trustees is excellent, but their proposed solution does not adequately address the needs of plan participants as a whole.

A better solution is to provide more than one pension plan to participants. Participants could then decide which plan would best meet their particular needs. For example, one pension plan could be designed for the needs of younger because the depleted assets will not be available to develop corporate opportunities or maintain current jobs.

98. Fischel & Langbein, supra note 10, at 1160.
99. See id.
100. Fischel and Langbein all but concede this point: “Recognition of a duty of impartiality . . . will not turn hard cases into easy ones.” Id.
101. See supra Part II.A.
102. Officers of target corporations that are successfully raided can lose their jobs. Coffee, supra note 63, at 24. This threat creates a strong incentive for corporate officers who are trustees of a pension plan to use the plan in a way that will thwart the takeover, regardless of the interests of any particular group of plan participants.
participants, and another plan could be designed for older participants. In the takeover situation a defined-contribution plan trustee representing the younger participants could very reasonably decide to try to save current jobs by purchasing target shares to prevent a takeover.\textsuperscript{103} In the same context, a defined-contribution plan trustee representing older employees might decide not to incur the loss that the takeover defense likely would entail. All that is required to make this example a reality is a mechanism that would allow plan participants to transfer their interests from the “younger” plan to the “older” plan as time went by and as they crossed a hypothetical age threshold. Congress’s decision to use a tax subsidy to encourage participants to prefer retirement savings would remain unaffected as long as both the “young” and the “old” pension plans received the same tax treatment.

The remainder of this Note will argue that by extrapolating the simple example of easily transferable “young” and “old” pension plans, many of the current problems and conflicts under ERISA could be resolved or abated. This solution requires conceiving of pension plan interests as securities—as assets that can be easily transferred.\textsuperscript{104} With the development

\textsuperscript{103} In such an instance, presumably not all of the “young” participants who are employees of the target corporation will have their pension assets invested in the same pension plan at the time of a hostile tender offer. As long as their interests are transferable and easily accessible, however, a group of “young” employees that wishes to defend against the takeover would be able to form a separate defined-contribution plan of their own for the express purpose of defending their targeted employer. Indeed, they may go a step further and establish their own acquisition plan to compete with an outside raider for control of the corporation. Under these special circumstances Congress should consider whether or not these employees might benefit from a “grace period” during which they would have an adequate amount of time to either assist the current management in the defense of the corporation or to establish an employee buy-out plan to compete with the raider.

Limits on the liquidity of pension plan interests may be appropriate. Employees might be tempted to sell their retirement interests discounted to present value for current cash consumption. Congress could create disincentives for this type of action by creating penalties for early withdrawal as well as by removing any deferral of income taxes on these assets.

\textsuperscript{104} The idea of treating pension interests as securities is broader than previous proposals made for pension interest portability. In general terms, a portability system would enable participants to transfer their interests from one employer’s plan to another, but only when participants change jobs:

Portability generally refers to an employee’s ability “to carry” earned benefits to the next employer. One of the reasons that no system of portability has been developed to date is that two fundamental questions must first be answered: (1) what benefits should be portable (all accrued benefits versus all vested benefits) and (2) should only benefit credits be transferred or should plan assets follow these credits?

Borzi, supra note 1, at 9 n.17; see generally id. at 35-37.
of a market for pension plan interests, market forces will supplement ERISA in disciplining pension plan trustees. Once this fundamental conceptual barrier is crossed, one can conceive of myriad pension plans competing for the deferred present income of all kinds of employees. Participants will be able to choose the portfolio of pension plans that best suits their needs, which will eliminate conflicts in takeover defense, social investment, and other situations. The added discipline of market-based competition for participant interests in pension plans should improve the performance of plan trustees as a whole and should increase public confidence in the pension system.

III. PENSION PLAN INTERESTS AS SECURITIES

Congress enacted broad regulations covering securities transactions in the wake of the Great Crash of 1929. If amended, these security regulations could cover interests in pension plans. Congress's purpose in enacting these regulations, the Securities Act of 1933 (1933 Act) and the Securities Exchange Act of 1934 (1934 Act), was to protect securities investors. The Supreme Court has noted that...
“[t]he fundamental purpose undergirding the Securities Acts is 'to eliminate serious abuses in a largely unregulated securities market.'” Disclosure requirements and prohibitions on fraud reflect Congress’s purpose.

The first inquiry, when considering any monetary interest in light of the securities laws, is whether the interest is a security. Some interests in pension plans are considered to be securities and others are not.


110. See infra note 116 and accompanying text.

111. See infra note 115 and accompanying text.


113. Compare International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979) (holding that interests in noncontributory, involuntary pension plans are not securities) and Black v. Payne, 591 F.2d 83, 87-88 (9th Cir. 1979) (holding that a contributory, but compulsory pension plan interest was not an investment contract), cert. denied, 444 U.S. 867 (1979) with Fulk v. Bagley, 88 F.R.D. 153, 164 & n.6 (M.D.N.C. 1980) (denying defendants’ motion to dismiss and holding that issues of fact exist as to whether a voluntary, noncontributory pension plan was a security)
Once a security interest has been found, the next inquiry is whether a "sale of" or an "offer to sell" the security has occurred.\textsuperscript{114} The Securities Acts prohibit fraud in connection with "sales of" and "offers to sell" securities.\textsuperscript{115}

Once the sale of, or offer to sell, a security has occurred, the next inquiry is whether the Securities Acts require disclosure of information concerning the security. Disclosure of information under the 1933 and 1934 Acts is accomplished through registration of a security under these acts.\textsuperscript{116} The 1933 Act and the 1934 Act provide exemptions from registration for some securities.\textsuperscript{117} If registration is required for a particular

\textit{and} Release No. 33-6188, \textit{supra} note 31, at 8965 ("Since 1941, the [SEC] and its staff have adhered to the position that interests in voluntary, contributory pension and profit-sharing plans are securities.") \textit{and} 2 L. Loss \& J. Seligman, \textit{supra} note 33, at 1046 ("The better view is that a voluntary, contributory, defined contribution plan may be a security, at least when the ultimate benefits for plan participants appear to be predominantly a factor of investment success rather collateral factors such as vesting requirements.") \textit{and} Mundheim \& Henderson, \textit{Applicability of the Federal Securities Laws to Pension and Profit-Sharing Plans}, 29 L. \& CONTEMP. PROBS. 795, 802 (1964) (pre-ERISA) ("When the Supreme Court's definition of investment contract is applied to the trusteed pension plan with which we are primarily concerned [the self-employed person's pension plan] the existence of a security is clearly indicated."). \textit{See generally} 2 L. Loss \& J. Seligman, \textit{supra} note 33, at 1042-46.

\textit{114.} Under the 1933 Act:

The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term "offer to sell", "offer for sale", or "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.


Similar provisions may be found in the 1934 Act: "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." 15 U.S.C. § 78c(a)(13) (1988). "The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of." \textit{Id.} § 78c(a)(14).

\textit{115.} "[T]he application of the registration and antifraud provisions of the 1933 Act depends on there being a 'sale' or an 'offer' of a security." Release No. 33-6188, \textit{supra} note 31, at 8969.


security, sales of that security without an effective registration statement are prohibited. Some interests in pension plans are exempted from registration and others are not.


The SEC describes the general regulatory structure of the 1933 Act, and the important consequences that flow from a registration requirement as follows:

Sections 5 and 17 of the Act are the principal provisions used to implement the Act's disclosure and antifraud purposes. Section 5 provides that every offer or sale of a security made through the use of the mails or interstate commerce must be accomplished through the use of a registration statement meeting the Act's disclosure requirements, unless one of the several exemptions from registration set out in sections 3 and 4 of the Act is available. Section 17 of the Act prohibits the use of fraud or misrepresentation in the offer or sale of a security.

Id. at 8962 (footnotes omitted).


Many plans are structured so that registration under the 1933 Act is not required. Where registration is necessary, an appropriate form for this purpose must be selected and all applicable requirements must be complied with. . . .

The principal form used to register securities issued in connection with employee benefit plans is Form S-8.


The SEC has provided the following guidance on when registration is required under the 1933 Act:

. . . The 1970 Amendments to section 3(a)(2) [15 U.S.C. § 77c(a)(2) (1988)] codified in part the [SEC]'s longstanding administrative position that interests or participations issued in connection with employee benefit plans need not be registered unless employee funds are used to purchase employer securities. In the Daniel decision [International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979)], however, the Supreme Court implied, in dictum, that the section 3(a)(2) exemption extends only to the interests or participations of plans in certain funding vehicles, rather than the interests of employees in the plans themselves.

The legislative history of the 1970 Amendments indicates that their original purpose was to alleviate a concern expressed by banks and insurance companies that there was no clear exemption from registration in the 1933 Act for interests in the collective funding vehicles maintained by those entities for employee benefit plans. While the amendments were under consideration, however, language was added that reflected the [SEC]'s consistent administrative practice of not requiring interests in plans to be registered except where employee money is used to buy securities of the employer.

. . . . .

The staff [of the SEC] recognizes that the Supreme Court, in the Daniel decision, did not endorse the broad view of the 3(a)(2) exemption described above. While the statements by the Court are entitled to serious consideration, they are dicta and therefore do not resolve the issue conclusively. This fact is reflected in Chief Justice Burger's concurring opinion, in which he stated that
Investors who purchase securities that must be registered receive greater protection than those who purchase exempted securities because the registration process discloses detailed information concerning a security to investors.120

Congress should amend the securities laws to bring pension plan interests within the definition of a security, to ensure that participating in a pension plan is considered a sale of a security, and to require the registration of most interests in pension plans to afford the greatest protection to plan participants and beneficiaries. Congress also should encourage the development of a market for pension plan interests. Such treatment of pension interests would not only serve the purposes of informing pension plan investors and of preventing fraud in the sale of such interests, but also would serve Congress's goal of increasing and safeguarding retirement savings.121

A. The Definition of a Security

Congress defined the term "security" by providing a list of the various interests which qualify, in both the 1933 Act122

"There is no need to deal, in this case, with the scope of this exemption, since it is not an issue presented for decision. . . ." In light of all of the foregoing, particularly the negative effects on many plans which might flow from a narrow construction of Section 3(a)(2), the staff will continue to view the exemption as being applicable to both interests in funding vehicles and interests in plans.

Id. at 8972-73 (footnotes omitted).


121. See infra Part IV.

122. Section 2(1) of the 1933 Act provides:

The term "security" means 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,
and the 1934 Act.\textsuperscript{123} Congress included in this list an “investment contract,” which is a general interest that has been utilized by the federal judiciary to bring novel or unforeseen investments within the purview of the 1933 and 1934 Acts.\textsuperscript{124} Congress, however, left “investment contract” undefined.\textsuperscript{125} The definition of an investment contract has been supplied by a line of Supreme Court cases commencing in 1943.\textsuperscript{126} The Court’s investment contract definition is limited

certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, 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.


\textsuperscript{123} Section 3(a)(10) of the 1934 Act provides:

The term “security” means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, \textit{investment contract}, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a “security”; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.


The Supreme Court has noted that “[t]he same Congress which passed the Securities Act in 1933 approved the Securities Exchange Act in 1934, and the definition of security contained in the 1934 Act is virtually identical to that in the earlier enactment.” Tcherepnin v. Knight, 389 U.S. 332, 342 (1967). The legislative history of the 1934 Act supports the view that the definition of security under the 1934 Act was intended to be “substantially the same as [that] in the Securities Act of 1933.” S. REP. NO. 792, 73d Cong., 2d Sess. 14 (1934), \textit{reprinted in} 5 \textit{LEGISLATIVE HISTORY, supra} note 108, item 17, at 14. The Supreme Court has held that the two definitions of security, and thus the scopes of the 1933 and 1934 Acts, are “virtually identical.” United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847 n.12 (1975). The Court recently reaffirmed this principle in Reves v. Ernst & Young, 110 S. Ct. 945, 949 n.1 (1990).

125 \textit{See SEC v. W.J. Howey Co.,} 328 U.S. 293, 298 (1946) (“The term ‘investment contract’ is undefined by the Securities Act or by relevant legislative reports.”).
126 In chronological order the cases are: \textit{SEC v. C.M. Joiner Leasing Corp.,} 320 U.S. 344 (1943) (holding that interests in land were not merely leaseholds but were
to its interpretation of the 1933 Act and the 1934 Act; it does not prevent Congress from enacting further legislation providing a different investment contract or security definition.

The Supreme Court in *Reves v. Ernst & Young*\(^{127}\) recently reaffirmed its view that the 1933 and 1934 Acts were enacted with a remedial purpose. The Court stated:

In defining the scope of the market that it wished to regulate, Congress painted with a broad brush. It recognized the virtually limitless scope of human ingenuity, especially in the creation of "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits," and determined that the best way to achieve its goal of protecting investors was "to define 'the term "security" in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security.'" Congress

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therefore did not attempt precisely to cabin the scope of the Securities Acts. Rather, it enacted a definition of "security" sufficiently broad to encompass virtually any instrument that might be sold as an investment.\textsuperscript{128}

Although the Court observed that Congress did not "intend to provide a broad federal remedy for all fraud,"\textsuperscript{129} it has found that some unusual investments fall within the protection of the 1933 and 1934 Acts.\textsuperscript{130} The Court has stressed that "form should be disregarded for substance and the emphasis should be on economic reality" [because] Congress' purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.\textsuperscript{131} The Court has found an investment to be a security when the public ordinarily would consider it to be one.\textsuperscript{132} The Court also considers whether a particular investment is protected adequately by federal regulation other than the securities laws before it extends the protection of the 1933 and 1934 Acts.\textsuperscript{133}

\begin{itemize}
  \item \textsuperscript{128} Reves, 110 S. Ct. at 949 (citations and footnote omitted).
  \item \textsuperscript{129} Marine Bank v. Weaver, 455 U.S. 551, 556 (1982).
  \item \textsuperscript{130} E.g., SEC v. W.J. Howey Co., 328 U.S. 293 (1946) (portions of citrus grove); Tcherepnin v. Knight, 389 U.S. 332 (1967) (withdrawable capital shares in an Illinois savings and loan association).
  \item \textsuperscript{131} Reves, 110 S. Ct. at 949 (quoting Tcherepnin, 389 U.S. at 336).
  \item \textsuperscript{132} See, e.g., Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985). The Landreth Court stated:
    
    Instruments that bear both the name and all of the usual characteristics of stock seem to us to be the clearest case for coverage by the plain language of the definition [in the 1933 Act]. First, traditional stock "represents to many people, both trained and untrained in business matters, the paradigm of a security." Id. at 693 (citation omitted). The Landreth Court also noted, however, that "the fact that instruments bear the label 'stock' is not of itself sufficient to invoke the coverage of the [Securities] Acts." Id. at 686.
  \item \textsuperscript{133} See Reves v. Ernst & Young, 110 S. Ct. 945, 952 (1990) ("Finally, we examine whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary."). In Weaver, the Court reasoned that certificates of deposit do not need the protection of the securities laws:
    
    Deposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising relating to the interest paid on deposits is also regulated. In addition, deposits are insured by the Federal Deposit Insurance Corporation. Since its formation in 1933, nearly all depositors in failing banks insured by the FDIC have received payments in full, even payment for the portions of their deposits above the amount insured.

\textit{Weaver}, 455 U.S. at 558 (footnotes omitted); see also International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 569 (1979) ("The existence of this comprehensive legislation
Any attempt to extend the definition of a security to encompass all pension plan interests must immediately confront the Supreme Court's reasoning in its 1979 decision in *International Brotherhood of Teamsters v. Daniel.* In *Daniel,* the plaintiff was a participant in a union pension plan that had been established before the enactment of ERISA. The union plan required that participants accrue twenty years of continuous service before they became eligible to receive plan benefits. The *Daniel* plan was a multiemployer defined-benefit plan. Mr. Daniel began working as a truckdriver in 1950, joined the union in 1951 and was credited with five years of service toward his pension when the plan was established in 1954. In December 1960, he was laid off for four months. After the interruption, Mr. Daniel resumed his employment and had accrued a total of over twenty-two years of service by 1974. When the plan

[ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans.”). Commentators have strongly criticized the Supreme Court's inquiry into the existence of other protective legislation when performing its investment contract analysis:

[This inquiry] is troubling for several reasons. First, by relying on the “context” clause to hold that application of the antifraud provisions is unnecessary if the transaction is governed by another comprehensive federal scheme, the Court arguably disregarded the legislative history of the Acts as well as its own previous interpretation of that clause. Second, the Court's failure to apply the *Howey* test in a meaningful way casts doubt on whether that test remains a viable mechanism for determining the presence of a “security.” . . . Moreover, the Court's insupportable presumptions about congressional intent threaten to undermine the objectives underlying the federal securities laws.

Steinberg & Kaulbach, *supra* note 126, at 503; see also Note, *supra* note 112, at 195-96 (“The Court's recent comparable protections approach suffers from two flaws. First, the context clause in the Securities Acts does not justify an examination of statutes offering comparable protections . . . . Second, the comparable protections approach fails to implement congressional intent.” (footnote omitted)); *id.* at 205-10 (analyzing *Weaver*).

135. *Id.* at 553.
136. *Id.* at 554.
137. Liebeler, *supra* note 2, at 722 (“A 'multi-employer' plan, covering the employees of financially unrelated employers, is generally collectively bargained and provides for transfer of pension credits among participating employers. These plans are often industrywide in operation and may be local, regional or national in scope.”).
139. *Daniel,* 439 U.S. at 554.
140. *Id.* at 555 n.4.
141. *Daniel,* 561 F.2d at 1226.
administrator and the trustees denied Mr. Daniel his pension benefits because of this involuntary break in his service, he sued the union and pension plan trustee under, inter alia, the securities laws.\textsuperscript{142} His legal theory was that his interest in the plan was a security which he had purchased through participation in the union plan and that the plan trustees had made misstatements and had not disclosed information about the plan as required by the 1933 and 1934 Acts.\textsuperscript{143}

The defendants argued that Mr. Daniel had no cause of action under the 1933 and 1934 Acts and moved for dismissal.\textsuperscript{144} The district court denied the motion,\textsuperscript{145} holding that Mr. Daniel's interest in the plan was a security,\textsuperscript{146} and that there had been a sale of that security to Mr. Daniel.\textsuperscript{147} The defendants appealed. Although the Court of Appeals for the Seventh Circuit unanimously affirmed the district court's decision,\textsuperscript{148} the Supreme Court reversed.\textsuperscript{149} The Daniel litigation provoked a great deal of commentary.\textsuperscript{150}

\begin{itemize}
\item \textsuperscript{142} Daniel, 439 U.S. at 555.
\item \textsuperscript{143} Id.
\item \textsuperscript{144} Id. at 556.
\item \textsuperscript{145} Id.
\item \textsuperscript{146} Id.
\item \textsuperscript{147} Id.
\item \textsuperscript{148} Daniel v. International Bhd. of Teamsters, 561 F.2d 1223 (7th Cir. 1977), rev'd, 439 U.S. 551 (1979).
\item \textsuperscript{149} Id.
\end{itemize}
In analyzing whether Mr. Daniel's interest in the union pension plan was a security, the district court, the Seventh Circuit Court of Appeals, and the Supreme Court relied on SEC v. W.J. Howey Co. in which the Supreme Court previously had defined an investment contract:

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

In United Housing Foundation, Inc. v. Forman, the Court added gloss to the Howey test by stating that the test was to be applied in light of "the economic realities of the transaction." The Seventh Circuit found that the Daniel pension compulsory, noncontributory pension plans are not securities); Comment, Securities Law—Pension Plans—Interests in a Noncontributory, Compulsory Employee Pension Plan Deemed Subject to the Antifraud Provisions of the Federal Securities Laws, 22 VILL. L. REV. 195, 204 (1976) (authored by Sara Lou Spielman) (describing as innovative the district court's holding that Mr. Daniel's interest was a security); Note, The Impact of the Daniel Litigation: Growing Interest in Pension Vesting and Investment Control, 1979 WIS. L. REV. 1228, 1250 (authored by Stephen J. Nording) (concluding that the Supreme Court's decision in Daniel was correct); Note, The Federal Securities Laws and Employee Pension Participants: Retiring Daniel, 87 YALE L.J. 1666, 1670-71 (1978) [hereinafter Note, Retiring Daniel] ("Given the vagueness of [the Howey] test, the Seventh Circuit's decision that employee interests in pension plans fall within its confines was arguably correct, even though contrary interpretations are also plausible." (footnotes omitted)).

152. Daniel, 561 F.2d at 1231.
155. Id. at 298-99.
157. Id. at 851. The decision in Forman signaled a change in the previously expansive interpretation of an investment contract:
[In its early post-Howey decisions construing the [Securities] Acts, the Court adopted a flexible, expansive interpretation of the three-part Howey test. The lower courts, expanding on the Howey test, followed suit. By the mid-1970s, however, the Court retreated from this remedial approach. The decision that signaled the Court's retreat was United Housing Foundation, Inc. v. Forman.

Steinberg & Kaulbach, supra note 126, at 495 (footnotes omitted).
plan had met the requirements of an investment contract under the *Howey* test, and therefore was a security.\textsuperscript{158} The Supreme Court disagreed.\textsuperscript{159} The Seventh Circuit got the better of the argument.\textsuperscript{160}

1. *Investment of money*—The Supreme Court in *Daniel* held that Mr. Daniel's participation in the pension plan did not involve an investment of money.\textsuperscript{161} The Court focused on the compulsory\textsuperscript{162} and noncontributory\textsuperscript{163} nature of the pension plan.\textsuperscript{164} It looked for "tangible and definable consideration in return for an interest that had substantially the characteristics of a security"\textsuperscript{165} and concluded that although an employee's services have value, the *Daniel* pension plan was part of an inseparable compensation package in which an employee's investment was insignificant; "[o]nly in the most

\textsuperscript{158} Daniel, 561 F.2d at 1231-38.

\textsuperscript{159} Daniel, 439 U.S. at 558-62.

\textsuperscript{160} See infra notes 161-83 and accompanying text. One commentator, reacting unfavorably to the Supreme Court's treatment of the *Howey* test in *Daniel*, stated that *Daniel* is extremely difficult to reconcile with the *Howey* approach. Carney, *Defining a Security: The Addition of a Market-Oriented Contextual Approach to Investment Contract Analysis*, 33 EMORY L.J. 311, 325-26 (1984). ("While Justice Powell's majority opinion continued to pay homage to the *Howey* approach, it ignored some of the 'economic realities' of the securities markets. . . . The result is an opinion that does not stand up well when judged solely against the *Howey* criteria.")

Another commentator explains his support for the Seventh Circuit's application of the *Howey* test in the following way:

Read in light of its judicial interpretation, the [*Howey*] test supports the [Seventh Circuit]'s conclusions that the employee's interest qualifies as an "investment," that the pension fund constitutes a "common enterprise," that the employee is "led to expect profits," and that the profits result solely from the efforts of others.

Note, *Retiring Daniel*, supra note 150, at 1671-72 (footnotes omitted); cf. Liebeler, supra note 2, at 748 ("Absent ERISA, a powerful argument could be made that the most efficient way to preserve the private pension system and at the same time promote employee retirement income security would be to subject employee interests in pension plans to the federal securities laws.").

\textsuperscript{161} Daniel, 439 U.S. at 560-61.

\textsuperscript{162} See supra notes 51-52 and accompanying text.

\textsuperscript{163} See supra notes 53-54 and accompanying text.

\textsuperscript{164} Daniel, 439 U.S. at 559. In the view of the SEC's Division of Corporate Finance:

The Supreme Court's opinion in [*Daniel*] . . . did not rest on the fact that the plan was a defined benefit one. Instead, the Court based its decision on the involuntary nature of the plan (unlike all prior cases of the Court involving securities, the employees did not have a choice whether to participate) and the fact that the plan did not provide for direct, identifiable contributions by employees (the employees' labor could be considered a contribution "only in the most abstract sense.").


\textsuperscript{165} Daniel, 439 U.S. at 560.
abstract sense may it be said that an employee ‘exchanges’ some portion of his labor in return for these possible benefits.” The Daniel Court also held that contributions to the pension plan by Mr. Daniel’s employer were not made on his behalf:

[T]here was no fixed relationship between contributions to the [defined-benefit plan] and an employee’s potential benefits. . . . One who has engaged in covered employment for 20 years will receive the same benefits as a person who has worked for 40, even though the latter has worked twice as long and induced a substantially larger employer contribution.  

The Daniel Court’s characterization of the “realities” of a pension plan transaction are open to question. A more realistic view of the transaction is that the Daniel plan involved a voluntarily investment of money. An employee receives significant compensation for her services in two forms. The first is her paycheck, which is present income. The second is in the form of deferred income, which is either deducted from her paycheck or contributed directly by her to a pension plan. The fact that the Daniel plan was noncontributory, and that the employer physically made contributions to the pension plan, cannot be determinative. The Daniel Court failed to recognize that the employees made a conscious decision, voiced through their union representatives, to participate and invest in a retirement plan.

166. Id.  
167. Id. at 561.  
168. Such a rule would create a large loophole in the coverage of the Securities Acts. Under such a rule, issuers, to avoid the securities laws, could simply interpose a “middleman” when selling securities and then claim that the purchaser made no investment.  
169. As Professors Fischel and Langbein explain: The typical pension or welfare benefit plan is operated by one employer for the employees of that firm. These so-called “single employer plans” may be the result of collective bargaining or may be sponsored by nonunionized firms. In some industries, however, particularly those in which employment patterns are episodic and in which multifirm or industry-wide collective bargaining is common (for example, the construction trades, entertainment, trucking, the needle trades), individual firms do not sponsor plans. Rather, the union takes the initiative through the collective bargaining process for establishing the pension and benefit plans, and numerous employers contribute to the union sponsored plan. Fischel & Langbein, supra note 10, at 1111.  
It should not matter that a particular employee joins a union after the pension plan is bargained for or that black letter labor law does not consider an individual employee
Even in cases where a collective bargaining process does not establish the pension plan, courts should view employees as voluntarily participating in the plan because they have elected to trade their services for a compensation package that includes a pension plan interest.  

Finally, by emphasizing the fact that contributions are not tied directly to a particular employee, the Court ignored the fundamental importance of the allocation of risk in a transaction creating a defined-benefit plan. The participants in Daniel's defined-benefit plan were not purchasing only a retirement benefit. They were purchasing a guaranteed benefit. The contract that created the plan in Daniel allocated the risk of plan losses to the sponsoring employers and allocated the risk of "over-contribution" by a forty year worker to the participants. Thus, it begs the question to determine that no investment was involved simply because there was no fixed relationship between contributions and benefits. This investment device's variable relationship and allocation of risk was precisely what the parties bargained for and what the participants invested in.

2. Common enterprise—The Seventh Circuit found that the union pension plan constituted a common enterprise under Howey. It stated: "Here the enterprise is common to all of the [union] members. The pension fund trustees self-admittedly exercise exclusive control over the common enterprise and the investment of its assets. The pension fund which receives the union members' investments is a common enterprise under Howey." The Supreme Court did not challenge the Seventh Circuit's holding on this point.

to be a party to a collective bargaining agreement. See Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1243 n.40 (7th Cir. 1977) (stating that an employee is not a party to the collective bargaining agreement "in the technical labor law sense"), rev'd, 439 U.S. 551 (1979). This employee should be viewed as having assented to the transaction after the fact. See id. at 1243.

170. Daniel, 561 F.2d at 1243 ("[V]olition is present to the extent that [the union] members voted whether or not to accept the collective bargaining contract containing this pension fund and whether to ratify subsequent agreements governing the level of employer contributions into the fund or seek dismissal of union officers or the unlikely radical measure of decertification of the Union."). Contra Daniel, 439 U.S. at 560.

171. Daniel, 561 F.2d at 1233.

172. Id.

173. See Daniel, 439 U.S. at 561-62. As Professor Carney explains: The Daniel decision contained no discussion of the common enterprise test nor did it address the issue of whether the significant managerial efforts were those of others. As to these tests there could be little doubt that Howey's
3. **Expectation of profits from the efforts of others**—In one of the most troubling parts of its opinion, the Daniel Court held that the union plan participants had no expectation of profits from the efforts of the plan trustee under the plan. The Daniel Court reasoned:

It is true that the [Daniel plan], like other holders of large assets, depends to some extent on earnings from its assets. In the case of a pension fund, however, a far larger portion of its income comes from employer contributions, a source in no way dependent on the efforts of the [Daniel plan]'s managers. The [Daniel plan], for example, earned a total of $31 million through investment of its assets between February 1955 and January 1977. During this same period employer contributions totaled $153 million. Not only does the greater share of a pension plan's income ordinarily come from new contributions, but unlike most entrepreneurs who manage other people's money, a plan usually can count on increased employer contributions, over which the plan itself has no control, to cover shortfalls in earnings.

The Daniel Court arguably misunderstood the operation of pension plans in general and defined-benefit plans in particular. Pension plans depend on earnings from their investments to generate assets, earnings that depend on the efforts of people other than the plan participants themselves. The fact that the Daniel plan earned only $31 million from investment profits does not support a finding that profits from pension plan investments are insignificant. For instance, one cannot determine from the Court's opinion whether the Daniel plan trustees pursued a conservative strategy with a lower

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standards were met, since funds in Daniel were pooled and managed by plan trustees in exactly the same manner as in a mutual fund.

Carney, *supra* note 160, at 327 (footnote omitted).


175. *Id.*

176. *Id.* As Professor Carney explains:

Clearly the pension plan [in Daniel] invested the employer contributions in exactly the same manner as any investment company made investments, and expected returns from its efforts, whether in the form of dividends from stocks bought, interest on corporate bonds, or appreciation of the portfolio. The magnitude of these gains would obviously depend upon the investment skill of the particular fund's managers.

Carney, *supra* note 160, at 327 (footnote omitted).
rate of return or a risky and potentially more profitable investment strategy.\textsuperscript{177} One fact is clear, however. During the period between February 1955 and January 1977, approximately 20% of the Daniel plan's income came from investment profits.\textsuperscript{178} These profits are by no means "one of [the plan's] less important aspects" as the Court claimed.\textsuperscript{179}

The fact that the employer in Daniel could be expected to make contributions to the plan to cover shortfalls is not surprising. The Daniel plan was a defined-benefit plan. The downside risk of plan investments rests with the sponsor of a defined-benefit plan.\textsuperscript{180} The fact that the employer agreed to guarantee benefits does not make the pension plan arrangement any less profit-motivated. The employer and plan participants bargained to allocate risks precisely this way. There can be no question that defined-contribution plans are profit-seeking and depend on earnings from assets because all investment risks in these plans are borne by plan participants.\textsuperscript{181}

The Daniel Court's final ground for holding that Mr. Daniel had little expectation of profits for the purposes of the Securities Acts was "the fact that where a plan has substantial preconditions to vesting, the principal barrier to an individual employee's realization of pension benefits is not the financial health of the [plan]. Rather, it is his own ability to meet the [plan]'s eligibility requirements."\textsuperscript{182} An investment is not any less a security because profits are contingent on specific events in the future. Investors buy shares hoping that future events will bring profits to the issuer of the shares.\textsuperscript{183} The

\textsuperscript{177} See Daniel, 439 U.S. at 561-62.
\textsuperscript{178} See supra note 175 and accompanying text.
\textsuperscript{179} Daniel, 439 U.S. at 561; see also Carney, supra note 160, at 327 ("The [Daniel] opinion . . . seemed to examine the actual operation of this particular plan, rather than what investors such as Daniel might reasonably have expected to occur.").
\textsuperscript{180} See supra notes 37-45 and accompanying text.
\textsuperscript{181} See supra notes 46-50 and accompanying text.
\textsuperscript{182} Daniel, 439 U.S. at 562.
\textsuperscript{183} Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1233 (7th Cir. 1977) ("[C]ontingent expectancies are the rule rather than the exception in the equity markets. Profits in an equity security require that the market value plus accrued dividends of a stock be greater than the stockholder's cash basis. Thus profits are contingent on the successful operation of the common enterprise . . . ."), rev'd, 439 U.S. 551 (1979).
merek existence of a contingency on the realization of profits could not be what led the Court to find that no security was present. If the magnitude of the contingency is troublesome, Congress should amend ERISA to reduce pension eligibility requirements.

B. Sale of the Pension Plan Interest

The Seventh Circuit held that a sale occurred when an employee traded services for an interest in the plan, bringing the transaction within the coverage of the Securities Acts. The Seventh Circuit found that a disposition of a security for value had occurred. Mr. Daniel had acquired an interest in a security and had supplied value for the interest by rendering services to his employer who then made contributions to the plan. The Supreme Court did not need to reach the issue of whether a sale had occurred because it found that no security was involved.

184. Id. at 1242-44.
185. Id. at 1242.
186. Id. In reaching its conclusion, the Seventh Circuit relied on recent SEC interpretations of the Securities Acts to the effect that acquiring an interest in a compulsory pension plan involved a sale. See id. at 1243-44. This new interpretation of the Securities Acts represented a reversal of the SEC's previous "no sale" policy. Id. at 1244 ("[T]he SEC had in the past applied a no-sale rule to pension trusts as to the registration requirements of the 1933 Act . . . ."). Judge Tone, concurring in the Seventh Circuit's opinion, was not impressed with the SEC's reversal of position:

[Considering the breadth of the definitions of "investment contract" and "sale" in the statutes themselves and the interpretation of those terms in cases we must still regard as authoritative, I believe the balance tips in favor of [Mr. Daniel]'s position. In reaching this conclusion, I have found little comfort in the opinion expressed by the SEC, as amicus curiae. Apparently for the first time ever, it now takes the position in its brief before us that the employee's interest or expectancy in a plan such as this is subject to the anti-fraud provisions of the securities laws.

Id. at 1251 (Tone, J., concurring); see also Liebeler, supra note 2, at 715-17.

In its reversal, the Supreme Court criticized the Seventh Circuit for being too deferential to the SEC's interpretation of the securities laws. Daniel, 439 U.S. at 563, 565-69.

C. Registration and Exemption

Mr. Daniel brought his claims under the antifraud provisions of the Securities Acts only; he did not claim that a prohibited sale of an unregistered security had occurred. Therefore, the issues of whether the Daniel pension plan was required to be registered and whether it was exempt from registration were not before the Court.

D. ERISA's Pervasive Regulatory Scheme

The Daniel Court added that "[i]f any further evidence were needed to demonstrate that pension plans of the type involved are not subject to the Securities Acts, the enactment of ERISA in 1974 . . . would put the matter to rest." This statement, however, is dictum. The Court's reliance on ERISA to protect plan participants and insure pension plan interests is arguably imprudent.

ERISA creates an impossible task for pension plan trustees because a pension trustee's investment decision requires a choice between the conflicting interests of different subgroups of plan participants. Almost invariably, an ERISA trustee's decision will adversely affect the interests of one subgroup of participants.

Reliance on ERISA's scheme of federal pension plan insurance also is not prudent. Defined-contribution plans are not covered by ERISA's insurance scheme. Only $631 billion of the $1.7 trillion in private retirement pension plan assets are insured.

188. See id. at 555-56.
189. Id. at 570 (Burger, C.J., concurring) ("I join in the opinion of the Court except as to the discussion of the 1970 amendment to § 3(a)(2) of the Securities Act [of 1933, which sets out exemptions for interests in pension plans]. There is no need to deal, in this case, with the scope of the exemption, since it is not an issue presented for decision.").
190. See id. at 569-70 (citation omitted). Commentators have criticized the Supreme Court's inquiry into the existence of other protective legislation. See supra note 133.
191. Steinberg & Kaulbach, supra note 126, at 505-06; Note, supra note 112, at 202 n.61.
192. See supra Parts I & II.
194. 1990 ABSTRACT, supra note 3, at 360 (table no. 591).
ERISA's enforcement mechanisms are lax, and public confidence in the private pension system has been shaken. Surrounding the Supreme Court's recent decision in Pension Benefit Guaranty Corp. v. LTV Corp were fears that a pension bailout might be on the horizon. Although some reports characterized the Court's decision as one that averted a bailout, is it prudent to rely solely on ERISA to protect private retirement assets?

Using pension plan assets to defend against takeovers and to make social investments has raised questions that the Daniel Court arguably did not consider in 1979. By refusing to characterize an employee's interest in a pension plan as a security, the Daniel Court created a financial marriage between plan participant and plan trustee, leaving the participant at the mercy of the trustee or with a costly remedy in the courts.

The Daniel Court's decision, of course, merely interprets the Securities Acts. Congress should enact legislation taking a more economically realistic view. Congress could provide

196. 110 S. Ct. 2668 (1990) (holding that the PBGC had the authority to order a corporation in bankruptcy to resume funding a terminated pension plan when the corporation's financial circumstances had improved dramatically).
197. This story appeared in the Washington Post four days before the LTV decision was handed down. See Swoboda, supra note 20, at C1, col. 2 ("The federal insurance fund protecting the pensions of 50 million American workers could soon find itself billions of dollars in debt and unable to meet its obligations . . .").
198. For example, one report stated:

The 8 to 1 decision in a case involving the LTV Corp. averted a potential financial crisis for the Pension Benefit Guaranty Corp., which insures $1 trillion in private pension benefits for 40 million workers much the way the Federal Deposit Insurance Corp. insures bank deposits. . . .

If the court had ruled against the PBGC, the agency would have had to assume $2 billion in LTV's pension liabilities and the door would have been opened for it to assume responsibility for other financially troubled companies in the future.

Swoboda, Pension Protection Broadened, Washington Post, June 19, 1990, at A1, col. 1; see also Arndt, Court Rules LTV Liable for Pensions—Steel Firm Ordered: Pay $2.5 Billion, Chicago Tribune, June 19, 1990, at A1, col. 6 ("The Supreme Court ruled Monday that bankrupt LTV Corp. must resume responsibility for voided pension plans, sparing the federal agency that insures the pensions of one of every five adults an enormous—and potentially ruinous—expense."); Savage, Pension Agency Powers Upheld, L.A. Times, June 19, 1990, at A1, col. 5 ("The Supreme Court ruled Monday that a corporation in bankruptcy can be forced to keep funding its pension plans, heading off a potential multibillion-dollar crisis for the federal agency that insures pensions for nearly 40 million Americans.").
pension plan participants with increased investment security by providing a market for pension investments and by requiring plan trustees to disclose information about plans under the securities laws. Market forces would then discipline plan trustees, and participants would have the simple self-help remedy of being able to transfer out of a plan not comporting with their interests.

IV. A POLICY ANALYSIS OF THE PENSION PLAN SECURITY

When Congress enacted ERISA in 1974, it balanced the benefits of regulating private pension plans against the costs of regulatory compliance.\textsuperscript{199} Congress was concerned with the abuses that occurred prior to ERISA,\textsuperscript{200} yet it also was concerned that overregulation might deter the formation of new pension plans or eliminate existing plans.\textsuperscript{201}

ERISA's "costs" include low confidence,\textsuperscript{202} low pension plan participation,\textsuperscript{203} and conflicts between plan participant subgroups.\textsuperscript{204} Significant benefits beyond those that ERISA

\textsuperscript{199} As the House Ways and Means Committee stated: [T]he committee has been mindful of the need to construct the new requirements so that they will provide meaningful improvement in the various problem areas noted under the present law. At the same time, the committee is aware that under our voluntary pension system, the cost of financing pension plans is an important factor in determining whether any particular retirement plan will be adopted and in determining the benefit levels if a plan is adopted, and that unduly large increases in costs could impede the growth and improvement of the private retirement system. For this reason, in the case of those requirements which add to the cost of financing retirement plans, the committee has sought to adopt provisions which strike a balance between providing meaningful reform and keeping costs within reasonable limits. H.R. REP. NO. 807, 93d Cong., 2d Sess. 14-15 (1974), \textit{reprinted in} 1974 U.S. CODE CONG. & ADMIN. NEWS 4670, 4681-82.

\textsuperscript{200} Id. at 13-14, \textit{reprinted in} 1974 U.S. CODE CONG. & ADMIN. NEWS 4670, 4681 ("There has also been concern about the administration of pension plans. It has been charged that all too frequently pension funds have not been used in the best interest of covered employees. There have been cases of extreme misuse of pension funds.").

\textsuperscript{201} Id. at 14-15, \textit{reprinted in} 1974 U.S. CODE CONG. & ADMIN. NEWS 4670, 4682; see also Liebeler, \textit{supra} note 2, at 726 ("But while Congress wanted to protect pension benefits, it was also concerned that federal regulation might eliminate or significantly reduce the number of private pension plans." (footnote omitted)).

\textsuperscript{202} See \textit{supra} note 20 and accompanying text.

\textsuperscript{203} See \textit{supra} note 23 and accompanying text.

\textsuperscript{204} See \textit{supra} Parts I & II.
Pension Plan Interests

provides could be attained by making pension interests transferable and marketable.\textsuperscript{205} Transforming these interests into securities and applying the securities laws to them is a plausible method for achieving the benefits of transferability and marketability.

In arguing that the securities laws should regulate transferable pension plan interests, a primary consideration is whether the costs of such a scheme would outweigh its benefits. The most obvious costs of this scheme would be incurred by pension plans in complying with the securities laws. The costs of compliance would involve specifically: the costs of learning how the securities laws would apply to pension interests; the costs to the government of administering

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\textsuperscript{205} I assume that a market for pension plan interests could be created. This assumption involves a chicken and egg question in that no market will exist until pension plan interests are transferable. Once transferability exists, creating a market should not be difficult. Shares in a pension plan would closely resemble shares in a mutual fund. I believe that assuming that a market for pension plan interests will exist does not involve "assuming the can opener." See Coffee, \textit{supra} note 120, at 739 n.64 ("This refers to the standard joke about the two scientists and an economist stranded on a deserted island with only a can of beans for food, which they cannot open. The physicist develops a theory for breaking open the can, and the chemist similarly devises a plan for boiling it open, but the economist suggests the simplest plan: 'Assume a can opener.'"). Some criticism of using the securities laws for the regulation of pension interests begins with the premise that there is no market for pension interests. The argument is essentially that because there is no market for pension interests that could process and value pension information, mandatory disclosure under the securities laws would not help plan participants:

The [Securities] 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. . . .

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. Unlike conventional investors, pension plan participants cannot expect services to spring up that would be capable of assimilating the data for them at an acceptably low cost [because there is no market intermediary evaluating disclosures under ERISA]. 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. Indeed pension interests are not "bought" and "sold" in markets anything like those the [Securities] Acts were intended to regulate.

\textit{Note, Retiring Daniel, supra} note 150, at 1685 (footnotes omitted). This argument loses its vitality in the presence of a market for transferable pension interests.
the new pension laws; and the costs to plans of disclosing required information under the securities laws.

Applying the securities laws to pension interests will involve learning costs on the part of plan trustees who will be required to comply with the securities laws. In addition, trustees will incur litigation costs in resolving ambiguities in the application of the securities laws to pension interests. The fact that these cost arguments militate against all legislative enactments weakens their strength considerably. Finally, after fifty years, the securities laws are venerable and many ambiguities under them have been resolved.

The debate over the costs and benefits of mandatory disclosure under the securities laws has evolved since the securities laws' enactment. This debate is relevant to applying the securities laws and mandatory disclosure thereunder to pension interests, in the context of a pension interest market. The initial justifications for requiring disclosure of information concerning a security were protection of individual investors and the integrity of the market. Professor Coffee, however, has discredited these rationales as
being insufficient to justify mandatory disclosure in the context of modern markets. Current arguments for mandatory disclosure involve several rationales.

Professors Loss and Seligman argue that the protection of individual investors and the integrity of the market leads to allocative efficiency in the capital markets. They argue that mandatory disclosure reduces the risk involved in trading securities. Thus, mandatory disclosure promotes several salutary goals:

[Mandatory] disclosure would tend to reduce the risk premiums that issuers selling new securities would have to pay, thus increasing the funds available for economic growth. Reduction of investors' concerns that securities fraud waves periodically may drive down securities price levels will tend to increase propensities to save. And reduction in the volatility of market price swings (caused by investor ignorance of material data) will tend to increase allocative efficiency.

212. Professor Coffee has noted the significant impact of the professional securities analyst on the operation of the capital markets:

Easy as it is today to criticize the original premise of the federal securities laws—i.e., that mandatory disclosure would enable the small investor to identify and invest in higher quality and lower risk securities—such criticism does not take us very far because its target has shifted. The securities markets have evolved significantly since the 1930's, and one of the most important developments is the appearance of the professional securities analyst.

The work of the securities analyst can be subdivided into two basic functions. First, the analyst searches for information obtainable from non-issuer sources bearing on the value of a corporate security. Second, the analyst verifies, tests, and compares the issuer's disclosures, both to prevent deliberate fraud and to remove the unconscious bias that usually affects all forms of information transfer.

Coffee, supra note 120, at 723-24 (footnotes omitted). Professor Coffee adds, "[t]hus, the contemporary impact of the '34 Act may lie less in providing usable information to the ultimate investor than it does in reducing costs for the securities analyst." Id. at 728.

213. Allocative efficiency in this context may be defined as the capacity of the capital markets to invest capital accurately and efficiently to ensure that scarce resources are put to their best use. See id. at 734-35.

214. See 1 L. LOSS & J. SELIGMAN, supra note 33, at 218-20.

215. Id.

Reviewing empirical evidence on the impact of the 1933 Act, Professor Coffee argues that, in fact, mandatory disclosure has increased the allocative efficiency of the capital markets:

The most logical conclusion to draw from this evidence is that allocative efficiency was enhanced and that investors thereby benefitted. The key point then is that the social benefit of the federal securities laws may exceed their benefit to investors. The beneficiaries of increased allocative efficiency include virtually all members of society, not just investors.217

From Professor Coffee’s perspective, the securities laws’ scheme of mandatory disclosure can “be seen as a desirable cost reduction strategy through which society, in effect, subsidizes search costs to secure both a greater quantity of information and a better testing of its accuracy.”218 He also argues that in the absence of a mandatory disclosure system, voluntary disclosure will not protect investors adequately because the interests of shareholders and managers of capital cannot be completely aligned, and “greater inefficiency would exist . . . because excess social costs would be incurred by investors pursuing trading gains.”219 The same benefits from mandatory disclosure will accrue to investors and society as a whole when mandatory disclosure is applied to transferable pension plan interests.

The costs of mandatory disclosure should not outweigh its benefits. ERISA already requires periodic reporting and disclosure.220 ERISA disclosure causes employers to incur costs but has limited utility because, in the context of non-transferable pension interests, employees cannot use it to choose between different pension investments. Once pension plan interests become transferable, disclosure will have much more utility.

To the extent possible, Congress should integrate disclosure under ERISA and the securities laws to avoid duplicative

217. Coffee, supra note 120, at 735-36 (footnote omitted).
218. Id. at 722.
219. Id.
220. 29 U.S.C. §§ 1021-1031 (1988); see also supra note 11.
efforts. Integrated disclosure can reduce the costs of disclosure by preventing duplicative reporting efforts.

A market for pension plan interests should increase significantly the number of people who are covered by pension plans. In her discussion of the inadequate coverage of ERISA pension plans, Borzi describes which employees are left uncovered and why. In the 1980s only 22.9% of the employees of companies with less than 100 employees had pension plans. "The workers least likely to be covered under a pension plan are those who are young, work for a small nonunion company of fewer than 100 employees, and earn less than $10,000 a year."

Borzi identifies four reasons why small companies do not establish plans:

• Small companies cannot take advantage of the economies of scale to limit the costs of establishing and administering plans.
• Pension plans in general, and defined-benefit plans in particular, are burdensome in the sense that they require supervisory efforts by company management, there is a disincentive to the formation of plans by small companies.
• The demands of operating a small business consume most of the management's energy, a small business is "unlikely to seek out someone to establish a plan."
• There is little or no incentive to market plans to these companies.


Professor Merritt Fox describes integrated disclosure this way:

The SEC, recognizing that publicly held corporations are required under the Securities Exchange Act of 1934 . . . to file periodic reports containing financial and other information of interest to prospective securities purchasers, now permits a large class of issuers to use a short form Securities Act [of 1933] registration statement that provides for this information to be incorporated by reference rather than repeated.


222. Borzi, supra note 1, at 23-30.
223. Id. at 24.
224. Id.
225. See id. at 25-28.
Borzi continues by suggesting three approaches to solving this problem.

First, small companies could be required to establish pension plans.\textsuperscript{226} She concludes that the adoption of this approach is unlikely because it requires "a reversal of our longstanding policy of a voluntary private pension system."\textsuperscript{227} Second, Congress could create tax incentives for establishment of plans by small companies.\textsuperscript{228} Borzi remains skeptical of this approach, however, concluding that "it is not clear that tax incentives will work."\textsuperscript{229} Finally, incentives could be created for third parties to market plans to small companies.\textsuperscript{230} Borzi concludes: "The hardest part of developing policy options in this area is the difficulty in identifying incentives [to market plans]. More creative study is certainly needed."\textsuperscript{231}

A market for pension plan interests would in large measure solve or abate these coverage problems by creating incentives to sell plan interests to small firm employees. Large investment firms can be expected to establish national pension plans, once a national market for these plans exists. These investment firms will have a profit-based motive to market interests in their pension plans to employees everywhere.

The development of a market for transferable interests in pension plans will produce immediate benefits for pension plan participants and trustees. The transferability of plan interests will substantially reduce a plan trustee's dilemma arising from an investment decision that divides pension participants. A trustee who announces a particular investment strategy can be assured that participants who disagree with the strategy will transfer out of the plan. Similarly, participants of other plans who think the strategy is sound will transfer into the fund. The pension plan trustee will, by definition, act in the exclusive interest of plan participants.

\textsuperscript{226} Id. at 26.
\textsuperscript{227} Id.
\textsuperscript{228} Id. at 27.
\textsuperscript{229} Id. "Many [small companies] are not profitable enough to pay taxes. The debate, therefore, over whether a tax credit or a tax deduction is a greater incentive is irrelevant. Unless a refundable tax credit is used as an incentive, tax incentives alone will probably not increase coverage significantly." Id. (footnote omitted).
\textsuperscript{230} Borzi, supra note 1, at 28. Borzi suggests that incentives to market either a simplified defined-contribution plan or a new type of multiemployer defined-benefit plan might exist if such plans were available. Id.
\textsuperscript{231} Borzi, supra note 1, at 29.
because plan participants will make the determination of what is in their exclusive interest. A market for pension interests should reduce conflicts between different employee groups because they will transfer to another plan if a trustee makes an undesirable decision.

An additional benefit is that the plan members will be able to diversify a greater portion of their assets—including their human and monetary capital—and move them away from their employer. Lack of asset diversification is a significant problem for employees who have all of their human capital invested with their employer. The pension interest security concept will allow an employee to direct her stream of deferred income to any pension plan she wants. An employee could diversify her pension plan capital away from any one particular pension plan because she will be able to invest in more than one plan. A rational investor will attempt to reduce her investment risks by diversifying her investment portfolio.

The overall cost of administering pension plans should decrease as administrators are forced to compete with each other for pension plan assets and as plan trustees try to reduce overhead and become more efficient to compete in the market for plan interests.

Society as a whole will benefit when the paternalistic misconceptions of the present system of retirement savings are debunked. Some people may believe that the average plan

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232. The trustee still will have plenty to worry about, though. If the strategy is fundamentally unsound, most participants will transfer out of the plan, leaving the trustee with no assets and without a job.

233. Professor Coffee argues:

Managers are inherently overinvested in the firm they serve . . . .

. . . (T)he manager's most important asset is his or her job. Although the manager generally does not have a recognized property right in his [or her] employment relationship with the corporation, this relationship still has a present value to the manager equal to the discounted earnings stream he or she expects to receive from that job (or career path) until retirement. . . .

. . . (T)he manager is over-invested [sic] in his [or her] own firm because the firm in its own interest rewards him [or her] with a generally nontransferable interest in itself through stock options and other fringe benefits.

Coffee, supra note 63, at 17-18.

234. Id. at 17 ("Modern financial theory assumes that rational shareholders will hold diversified portfolios.").

235. See P. AREEDA & L. KAPLOW, ANTITRUST ANALYSIS—PROBLEMS, TEXT, CASES 8 (4th ed. 1988) ("Competitive forces generate efficiency in two ways. Productive efficiency occurs as low cost producers undersell and thereby displace the less efficient. Allocative efficiency occurs as exchanges in the marketplace direct production away from goods and services that consumers value less and toward those they value more . . . .").
participant does not have the sophistication to take advantage of the additional contractual freedom which a market for pension interests would provide. I disagree. First, all plan participants will have a strong incentive to take advantage of the market. Rational plan participants will want to make, not lose, money. Second, I believe that most plan participants are sophisticated enough to take advantage of the opportunities in a pension interest market. Even granting that there may be a threshold level of market sophistication among plan participants below which the choice of plans will not be meaningful, many participants will benefit from the freedom of choice that they gain.

V. CONCLUSION

If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance. As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position.

This passage concerning the 1934 Act, written over 50 years ago, is relevant today in the context of transferable pension plan interests. ERISA's pervasive regulatory scheme is fundamentally flawed. In pension plan takeover defenses, social investments, and other situations, plan trustees cannot satisfy ERISA by acting for the exclusive benefit of plan participants because the members themselves have conflicting interests. Courts and commentators have struggled to reconcile the interests of plan trustees and plan participants with the goals of ERISA, but they have yet to achieve a satisfactory solution.

236. Plan participants could hire a portfolio manager to take advantage of the market for them if they do not believe that they can make the best investment choices.

These difficult problems could be resolved or reduced by implementing the concept of a transferable pension plan interest and by encouraging the development of a market for such interests. Plan participants then could invest in pension plans which meet their particular needs, and plan trustees no longer would face the impossible task of satisfying plan participants with mutually exclusive interests. In addition, the inadequate level of trustee monitoring currently tolerated under ERISA would be supplemented by the discipline of a market competing for pension plan capital.

New legislation transforming pension plan interests into transferable securities and encouraging a market for these interests will produce positive societal gains. Pension plan capital will be allocated more efficiently and plan participants will enjoy increased contractual freedom. Congress should reconsider the decisions it made in 1974. Once again, it is time for the law to advance.