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## LEGAL ASPECTS OF THE ADOPTION BY A BUSINESS CORPORATION OF A SAVINGS AND INVESTMENT PLAN

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Employee savings and investment plans received wide publicity in 1955 when the Ford Motor Company and General Motors Corporation offered to establish such plans as a means of settling their dispute with the United Auto Workers over demands for a guaranteed annual wage.<sup>1</sup> While the advantages of savings and investment plans have been well known to employee-relations and tax experts for some

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1. See Bureau of National Affairs, Daily Report for Executives, Sept. 15, 1955, N-1, in which the following is stated:

"A series of developments in collective bargaining this year has turned industry's attention back to an almost-forgotten idea—the employee stock-purchase plan.

"The automobile giants last spring put the spotlight on stockbuying with their offer to sell workers shares on advantageous terms. . . . Several large corporations have indicated interest in the idea and could start an economy-wide vogue. Ford Motor Co. touched off the current flurry in May, in an effort to head off union demands for a guaranteed wage. Ford offered to sell employees stock at bargain prices. The union would not take the plan as a substitute, though.

"Then General Motors came up with a similar offer. Though the union rejected this one, too, GM plans to put something like it into effect for salaried workers next month."

General Motors instituted a savings-investment program for salaried employees in October 1955, and the Ford Motor Company adopted a similar plan for its salaried people in February of 1956. Wall Street Journal, Feb. 27, 1956, p. 14, col. 2. The Chrysler Corporation Board adopted a similar plan subject to stockholder approval. CHRYSLER CORPORATION, 1956 PROXY STATEMENT 1.

time, until 1953 their adoption was largely concentrated in the petroleum industry.<sup>2</sup> Since that time a number of employers in other fields have adopted such plans and others have indicated interest in similar plans.<sup>3</sup>

The stated objectives of these plans are varied. They, of course, encourage thrift and by providing the employee with a method of acquiring the employing company's stock, create an interest in stock ownership.<sup>4</sup> Some plans have been adopted with the objective of educating the worker in the advantages of the free enterprise system and to provide a hedge against inflation;<sup>5</sup> others are designed as supplements to the employer's retirement plan.<sup>6</sup>

A number of legal problems are involved in a company's decision to offer its employees a savings and investment plan.<sup>7</sup> These include questions of tax and corporation law, and questions under federal and state laws regulating the sale and issue of securities, wages and hours of workers and collective bargaining. It is the purpose of this article to set forth some of the principal legal aspects involved in the adoption of a savings and investment plan and to indicate briefly what they involve. To understand more clearly the discussion of the legal aspects, it is first necessary to summarize the salient features of the type of plan with which we are here concerned.

#### PRINCIPAL FEATURES OF EMPLOYEE SAVINGS AND INVESTMENT PLANS

Plans of companies in the petroleum, automotive, chemical, food and electronic industries have been examined in the preparation of

2. FORDE, *EMPLOYEE SAVINGS AND INVESTMENT PLANS* 4 (National Industrial Conference Board Studies in Personnel Policy No. 133, 1953).

3. See Bureau of National Affairs, Daily Report for Executives, Sept. 15, 1955, N-1.

4. "The Savings and Stock Bonus Plan should first of all encourage employee savings . . . [T]he bonus of G-E stock will make you a stockholder and will give you an opportunity to share in the growth of your company." GENERAL ELECTRIC, *EMPLOYEES SAVINGS AND STOCK BONUS PLAN BOOKLET 1* (1949) (hereinafter cited as G.E. PLAN).

5. FORDE, *op. cit. supra* note 2, at 3. In the Wall Street Journal, Feb. 27, 1956, p. 1, col. 1, the President of Inland Steel Company is quoted as saying that plans of this type "should create a better understanding of our economic system; they should produce greater loyalties and incentives; and above all, if launched on a widespread scale throughout the country, they should be a strong force in helping to preserve our free, competitive, private enterprise system."

6. FORDE, *op. cit. supra* note 2, at 3.

7. A number of names are given to plans of the type discussed. *E.g.*, Thrift Plan, Stock Plan, Savings Program, Employee Savings Plan, Employee Savings and Stock Bonus Plan, Savings-Stock Purchase Program, Employee Savings-Investment Plan. The names Savings Plan and Thrift Plan seem to be the most popular. For convenience, in this article these plans are called savings and investment plans. As pointed out later these plans should not be confused with those stock purchase plans which gained wide popularity following World War I. See text at notes 54-59 *infra*.

this article. While all of the plans of companies in these fields have not been reviewed, it is believed that the principal provisions hereinafter discussed are fairly representative of current savings and investment plans.

### *Eligibility*

Generally, all regular employees who have completed a specified period of service are eligible to participate in these plans. The period of service that employees must have completed to enroll in the plans varies. At least one plan does not require any service prior to enrollment, while others specify some service as a prerequisite to participation.<sup>8</sup> Under several plans employees cannot participate unless they become members or continue as members of the employer's pension or retirement plan.<sup>9</sup> In one plan, directors and employees whose annual compensation exceeds \$11,000 are barred from participation.<sup>10</sup> Another restricts enrollment to employees over twenty-one years of age.<sup>11</sup> And in plans of certain of the automotive companies, eligibility is limited to salaried employees.<sup>12</sup>

### *Employee and Employer Contributions*

In a few of the plans studied the minimum and maximum amounts the employee can contribute are expressed in terms of dollars.<sup>13</sup> But

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8. *E.g.*, E. I. DU PONT DE NEMOURS AND COMPANY, THE THRIFT PLAN § II (1955) (hereinafter cited as THE DU PONT THRIFT PLAN) (two years); FORD MOTOR COMPANY, SAVINGS AND INVESTMENT PROGRAM para. II (1956) (hereinafter cited as FORD PLAN) (nine months); GENERAL FOODS, BOOKLET ON FACTS ABOUT THE EMPLOYEE SAVINGS-INVESTMENT PLAN 6 (1953) (hereinafter cited as G.F. PLAN) (three years); GENERAL MOTORS, SAVINGS-STOCK PURCHASE PROGRAM FOR SALARIED EMPLOYEES IN THE UNITED STATES art. I, § 1 (1955) (hereinafter cited as G.M. PLAN) (one year); HERCULES POWDER COMPANY, *Employee Savings Plan*, 1956 PROXY STATEMENT § III (hereinafter cited as the HERCULES PLAN) (twenty-four months); SOCONY-VACUUM OIL COMPANY, INC., EMPLOYEE SAVINGS PLAN art. II (1951) (hereinafter cited as SOCONY-VACUUM PLAN) (no previous service required). The texts of the plans referred to in this article can be found in registration statements, reports or proxy statements of the respective companies, which are on file for public inspection in the Securities and Exchange Commission. The companies referred to also publish booklets containing the plans for distribution to their employees.

9. *E.g.*, CITIES SERVICE COMPANY AND PARTICIPATING SUBSIDIARY COMPANIES, THRIFT PLAN FOR THE EMPLOYEES art. II, § 1 (1952) (hereinafter cited as CITIES SERVICE PLAN); OHIO OIL COMPANY, A SAVINGS PROGRAM FOR EMPLOYEES, THE THRIFT PLAN § II(2) (1953) (hereinafter cited as OHIO OIL PLAN).

10. GULF OIL CORPORATION AND PARTICIPATING SUBSIDIARIES, EMPLOYEES SAVINGS PLAN § 2(1) (1954) (hereinafter cited as GULF PLAN). Other plans exclude directors and officers. *E.g.*, G.E. PLAN § II 1.

11. G.F. PLAN 6.

12. *E.g.*, FORD PLAN para. I 3; G.M. PLAN art. I, § 1.

13. *E.g.*, THE DU PONT THRIFT PLAN § V 2 (minimum monthly deduction \$12.50; maximum monthly deduction \$37.50); G.E. PLAN § III 2 (weekly payroll \$.75 minimum, \$10 maximum; semi-monthly payroll \$2 minimum, \$21.75 maximum; monthly payroll \$4 minimum, \$43.75 maximum).

in most plans employee contributions are based on percentage of pay.<sup>14</sup> Certain plans guarantee the employee-participant that he will receive securities and cash of a value at least equal to the amount of his contributions.<sup>15</sup>

Savings and investment plans also contain provision for contributions by the employing company. As in the contributions of employees, plans differ as to the extent of the employer's contribution. The employing company usually contributes amounts ranging from fifteen to fifty per cent of the total paid in by the employees.<sup>16</sup>

### *Investment of Contributions* •

Important questions in adopting a savings and investment plan are: (a) in what type of security should contributions of the employee and employer be invested, and (b) should the employee have a choice as to the investment medium. Although some plans do not provide the employee with any investment option as to his savings,<sup>17</sup> a number offer the employee various investment alternatives. This choice is limited by some plans to United States government obligations or the employer's stock.<sup>18</sup> Other plans, in addition to the above option, provide selections of insurance and annuity contracts<sup>19</sup> and securities

14. *E.g.*, CHRYSLER CORPORATION, 1956 PROXY STATEMENT 17 (10% of base compensation but not more than \$2,500 in any year); FORD PLAN para. IV (10% of pay, but not in excess of \$2,000); G.M. PLAN art. I, § 2 (employee may save up to 10% of salary); HERCULES PLAN § VIII (employee may save up to 10% of his base pay or a monthly total amount equivalent to 10% of one-twelfth of his total compensation received from the company for the preceding year, whichever is greater, but not less than \$13 per month); OHIO OIL PLAN § IV (2%, 4%, 6% of gross pay; after twenty years of service, up to 8% of gross pay); SOCONY-VACUUM PLAN art. III (1%, 2%, 3%, 4% or 5% of the mean of the annual base pay classification applicable to each employee as set forth in schedule in plan).

15. CHRYSLER CORPORATION, 1956 PROXY STATEMENT 17; FORD PLAN para. XVII; G.M. PLAN art. I, § 10.

16. *E.g.*, CHRYSLER CORPORATION, 1956 PROXY STATEMENT 16 (40% if corporation's consolidated net earnings for any year are more than 5% of net sales for that year but not more than 7%, the company's contribution is 50%; if consolidated net earnings are more than 7%, the company's contribution is 60%); THE DU PONT THRIFT PLAN § IV (25%); G.M. PLAN art. I, § 3 (50%); G.E. PLAN § V 1(a) (15% of the aggregate cost of savings bonds purchased by the employee under the plan); HERCULES PLAN § IV (25% to short-time savings and 25% to long-term savings plan; employees may participate in both plans); UNION CARBIDE AND CARBON CORPORATION, SAVINGS PLAN FOR EMPLOYEES § I B 2 (1953) (hereinafter cited as U.C.C. PLAN) (10% if participant has one-year but less than two-years' service credit, 20% if participant has two years but less than three years, or 30% if participant has more than three years of service).

17. *E.g.*, THE DU PONT THRIFT PLAN §§ III, IV (employees' contribution is limited to United States Savings Bonds, Series E; company's contribution invested in du Pont stock); G.F. PLAN 2 (investment medium limited to G.F. stock); G.M. PLAN art. I, § 4 (employee's contribution invested 50% in direct obligations of United States Government and 50% in G.M. common stock).

18. *E.g.*, HERCULES PLAN § X.

19. *E.g.*, STANDARD OIL COMPANY (N.J.), EMPLOYEES' THRIFT PLAN pt. VII, § 4 (1954) (Standard's common stock, United States Government securities, life or endowment insurance and annuity contracts).

of specified investment companies.<sup>20</sup> And one of the plans reviewed gave the employee the option of investment of his savings in any security, other than securities of the employing company, listed on the New York Stock Exchange and bonds of various governmental agencies.<sup>21</sup> The employer's contributions to the plan are generally limited to investment in its securities.<sup>22</sup>

There are also differences as to the source of the employer company's stock. Several plans state that stock of the employer should be purchased in the open market or from other sources.<sup>23</sup> One plan specifies that the trustee shall make purchases of the company's stock in the open market or from the company, if treasury or authorized unissued common stock is made available by the company for the plan.<sup>24</sup> Generally, the cost of stock purchased for an employee's account is the average cost of all the securities purchased during a specified period.<sup>25</sup>

Under several plans examined, income from investment of the contributions is credited to the employee's account.<sup>26</sup> In others income from investment of the contributions is invested in the same type of security which produced it.<sup>27</sup> A few stipulate that such income is distributable to the employee-participant prior to the time the income-producing securities are delivered to him.<sup>28</sup>

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20. SOCONY-VACUUM PLAN art. IV (United States Government bonds, Socony-Vacuum Capital Stock of designated investment companies).

21. TIDE WATER ASSOCIATED OIL COMPANY AND CERTAIN SUBSIDIARIES, THRIFT PLAN FOR EMPLOYEES art. V 1 a ii (1953) (hereinafter cited as TIDE WATER PLAN).

22. *E.g.*, THE DU PONT THRIFT PLAN § IV; G.M. PLAN art. I, § 5.

23. *E.g.*, CITIES SERVICE PLAN art. VI, § 2(a) (purchases of stock shall be in open market or from other sources); U.C.C. PLAN § III B 1d (purchases of stock of corporation made on New York Stock Exchange or at a price not exceeding last price on Exchange for preceding day; no securities can be purchased from U.C.C.)

24. *E.g.*, HERCULES PLAN § XIV(F). Under THE PURE OIL COMPANY AND PARTICIPATING SUBSIDIARIES, EMPLOYEES' SAVINGS AND STOCK BONUS PLAN § X (1953), stock can be bought from company at book value or in the open market of an established stock exchange, whichever price is lower at date of purchase.

25. *E.g.*, SOCONY-VACUUM PLAN art. IV(6) (average cost for month in which purchased); U.C.C. PLAN § III B 2 (average cost during purchasing period of approximately thirty days).

26. *E.g.*, CONTINENTAL OIL COMPANY, THRIFT PLAN art. VII (1952) (hereinafter cited as CONOCO THRIFT PLAN); THE TEXAS COMPANY, EMPLOYEE SAVINGS PLANS § V (1952) (hereinafter cited as THE TEXAS COMPANY PLAN) (word "income" includes interest, dividends, difference between redemption price and cost of government securities and any increments determined by the trustee and the company to be properly classifiable as income).

27. *E.g.*, THE DU PONT THRIFT PLAN § VII 3 (prior to time du Pont stock registered in the name of participant; income from such stock re-invested in du Pont common stock; only the company's contribution used to purchase du Pont stock); HERCULES PLAN § XIV(G) (interest received on United States Government securities invested in United States Government securities; dividends and other earnings received on common stock invested in common stock of the company; Hercules common stock and United States Government securities only investment media).

28. *E.g.*, THE DU PONT THRIFT PLAN § VII 6 (after the du Pont stock is registered in the employee's name, any cash or property dividends payable on such stock during the period held by the trustee will be paid by the company to the participant). See FORDE, *op. cit. supra* note 2, at 6.

As to voting the shares prior to distribution to the employee, some plans provide that only the trustee shall have the right to vote the employing company's stock held in trust.<sup>29</sup> Under other plans the trustee has the voting rights with respect to all shares held, but he must vote the shares in accordance with the directions of the employee-member for whom the stock is held.<sup>30</sup> In one of the plans reviewed, the employee-participant may vote the stock as soon as a share is registered in his name although it is in the custody of the trustee.<sup>31</sup>

### *Distribution to Employees*

In what has been described as the terminal-distribution<sup>32</sup> or long-term savings fund<sup>33</sup> type of plan, the securities purchased with the contributions from the employee and employer are not distributed until retirement unless the employee voluntarily withdraws from the plan or his service is terminated.<sup>34</sup> This kind of plan emphasizes the long-term accumulation of funds for old age.<sup>35</sup> In those plans described sometimes as the periodic-distribution type, there are various holding periods prior to distribution to the employee, usually of five years or less.<sup>36</sup> Some companies have both terminal and periodic-distribution type plans.<sup>37</sup>

Plans vary widely as to the manner of distribution of the assets in an employee's account at termination of service for reasons other than death or retirement. Employees terminating from certain plans by separation from employment through discharge for cause or through resignation with less than sixty months of participation will receive from their accounts only the value represented by their own contributions.<sup>38</sup> A chemical company's plan states that when an employee terminates for reasons other than resignation or discharge for cause, the total contributions to his account will be distributed to him.<sup>39</sup> If his termination from the plan is due to resignation or dis-

29. *E.g.*, HERCULES PLAN § XIV(H); THE TEXAS COMPANY PLAN § VIII(4).

30. *E.g.*, CONOCO THRIFT PLAN art. VI(9)(a). For more detailed discussion, see FORDE, *op. cit. supra* note 2, at 14.

31. THE DU PONT THRIFT PLAN § VII 5.

32. FORDE, *op. cit. supra* note 2, at 6.

33. See HERCULES PLAN § VI.

34. Some companies which have this type of plan are Abbott Laboratories, Atlantic Refining Company and Socony-Vacuum Company. See FORDE, *op. cit. supra* note 2, at 6.

35. *Ibid.*

36. *Id.* at 5.

37. See, *e.g.*, G.M. PLAN arts. II, III; HERCULES PLAN §§ V, VI.

38. CITIES SERVICE PLAN art. IX, §§ 6, 2; TIDE WATER PLAN art. VIII 52.

39. HERCULES PLAN § XIII.

charge he will receive in kind the total amount of securities and cash credited to his account, less the employer's contribution for the eighteen-month period immediately preceding termination, and earnings on the employer's contributions.<sup>40</sup> An employee of another chemical company who terminates for any reason after one year of the effective date of his participation is given the full amount contributed by the company.<sup>41</sup> An employee or his beneficiaries under this plan also will be paid all of the company contribution prior to one year of participation if he retires, is transferred to a subsidiary company, is laid off due to lack of work, dies or the plan is terminated.<sup>42</sup>

### *Withdrawals*

Savings and investment plans generally provide that the employee may wholly or partially withdraw his assets from the plan prior to the date the assets normally are distributable to him.<sup>43</sup> Usually, as is the case in terminations from the plan for reasons other than death or retirement, an employee who withdraws from the plan before the specified term is penalized by receiving none or only part of the employer's contribution.<sup>44</sup> In addition, employees who withdraw their share of the assets from the plan are not permitted to re-enter the plan again for a period of time.<sup>45</sup>

### *Suspension of Contributions*

Recognizing that from time to time an employee may have good reason for stopping his contributions, savings and investment plans also generally contain suspension privileges. The plans examined indicate that a popular maximum period of suspension is

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40. *Ibid.*

41. THE DU PONT THRIFT PLAN § IX 2(a).

42. *Ibid.*

43. *E.g.*, G.M. PLAN art. I, § 8, art. III, § 2 (under the Retirement Thrift Plan withdrawal may be made of securities purchased with employee's savings after the end of the fifth year following the formation of a class; as long as the employee remains in the service of the corporation, no withdrawal may be made of assets attributable to the corporation's contributions); HERCULES PLAN § XII(A)(B); U.C.C. PLAN § III C.

44. *E.g.*, THE DU PONT THRIFT PLAN § IX 2(a) (employee receives full amount of employer's contribution if he has participated one year or more); G.M. PLAN art. I, § 8 (if withdrawal is during five years following formation of a class, employee receives only that portion of the General Motors common stock and cash attributable to the corporation's contribution and earnings thereon as shall have been earned out at the rate of 2¾% per complete month beginning with the third year following formation of the class); TIDE WATER PLAN art. VIII 2 (if participant withdraws prior to sixty months of participation he will not receive any of the company's contribution).

45. THE DU PONT THRIFT PLAN § V 7(a) (one year); HERCULES PLAN § XII A (six months); TIDE WATER PLAN art. VIII 4 (twelve months); U.C.C. PLAN art. III C b (twelve months).

three months within a twelve month period.<sup>46</sup> Other permissible suspension periods range from two months to an indefinite period.<sup>47</sup>

### *Administration of the Plan*

There are a number of substantial differences among plans with respect to their administration. The boards of directors of several companies have specifically retained the power to administer the plan.<sup>48</sup> In some cases boards have delegated authority to administer the plans to single administrators<sup>49</sup> or to special committees.<sup>50</sup>

A number of administrative details are performed by trustees under trusts created as part of the plans. Trustees, among other things, invest the contributions to the plan in accordance with the instructions of the participants, hold the cash and securities, vote the shares in trust, notify the employee-participants of the status of their accounts and make final distribution of the trust assets.<sup>51</sup>

In many of the plans studied, costs of administration are borne by the employing company. These include brokerage, trustee and attorneys' fees, and transfer taxes.<sup>52</sup>

It is noted, too, that the plans under discussion contain statements to the effect that the decision of the employing company in all matters concerning the interpretation and application of the plan shall be conclusive.<sup>53</sup>

### *Stock-Purchase Plans Distinguished*

Employee savings and investment plans should not be confused with those employee stock-ownership or purchase plans which reached their height of popularity during the 1920's.<sup>54</sup> It is reported that a

46. See, e.g., CITIES SERVICE PLAN art. VIII.

47. E.g., THE DU PONT THRIFT PLAN § V 6 (thirty to sixty days); HERCULES PLAN § XI(A) (two months); SOCONY-VACUUM PLAN art. VI(2) (period not less than ninety days or more than aggregate twelve months in any period of five years); U.C.C. PLAN art. I B 3 (apparently no time limitation).

48. E.g., TIDE WATER PLAN art. IX 2; U.C.C. PLAN art. V A.

49. E.g., CITIES SERVICE PLAN art. XIV, § 2; OHIO OIL PLAN art. XIV.

50. E.g., G.E. PLAN § IX (committee of five members appointed by president); SOCONY-VACUUM PLAN art. IX(2) (committee of three members, one from legal department, one from industrial relations department and the third from treasurer's department).

51. For plans which specify these duties, see HERCULES PLAN § XIV; TIDE WATER PLAN art. X.

52. E.g., THE DU PONT THRIFT PLAN § XI; G.E. PLAN § IX 6. *But cf.* TIDE WATER PLAN art. V 3 (The trustee shall add to the cost of securities purchased for a group any brokerage commission, transfer taxes and other charges and expenses incident thereto. All other costs are borne by the company. *Id.* art. XIV.).

53. E.g., THE DU PONT THRIFT PLAN § II; G.E. PLAN § IX 5; HERCULES PLAN § XVIII.

54. See BROWDER, STOCK OWNERSHIP PLANS FOR WORKERS (National Industrial Conference Board Studies in Personnel Policy No. 132, 1953).



number of employee participants in such plans suffered heavy financial losses following the 1929 crash.<sup>55</sup> As a result, that type of plan never regained its pre-1929 popularity.<sup>56</sup>

There are a number of differences between savings and investment plans and their predecessor stock-purchase plans. In the older type stock-purchase plan an offering of a certain number of securities is made at irregular intervals or perhaps only once,<sup>57</sup> while offerings under savings and investment plans are of a continuing nature. In the usual savings and investment plan the employee does not subscribe to a certain number of shares as does the participant in a stock-purchase plan.<sup>58</sup> And the participant in the older stock-purchase plan does not receive a contribution from the employing company such as is given to the participant in the savings and investment type plan.<sup>59</sup>

Although some of the legal aspects hereinafter discussed are applicable to the older type stock-purchase plans, it is intended that this article be confined to savings and investment plans.

## GENERAL LEGAL ASPECTS

### *Corporate Power*

There can be no doubt that it is within the power of a corporation to offer a savings and investment plan to its employees. If this power is not specifically provided for in the applicable state statute<sup>60</sup> or in the charter, the authority to adopt such a plan clearly is within the implied powers.<sup>61</sup> As stated by one court, matters concerning the subject of employees, including the number of employees, salaries, vacations, sick pay and hospital benefits, relate to the internal management of the corporation and, as such, are within its implied powers.<sup>62</sup>

### *Stockholder Approval*

In the absence of provisions to the contrary in the laws of the state of incorporation, the corporate charter or the by-laws, there is

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55. Wall Street Journal, Feb. 27, 1956, p. 1, col. 1.

56. See BROWDER, *op. cit. supra* note 54, at 6.

57. *Id.* at 5.

58. *Ibid.*

59. *Ibid.*

60. At least two states have such statutes. CAL. CORP. CODE ANN. § 1107 (Deering 1953); MONR. REV. CODES ANN. § 15-801 (1947).

61. See, *e.g.*, Heinz v. National Bank of Commerce, 237 Fed. 942, 952 (8th Cir. 1916); People *ex rel.* Metropolitan Life Ins. Co. v. Hotchkiss, 136 App. Div. 105, 120 N.Y. Supp. 649 (3d Dep't 1909).

62. Heinz v. National Bank of Commerce, *supra* note 61, at 952-53. See also Eliasberg v. Standard Oil Co., 23 N.J. Super. 431, 92 A.2d 862 (1952), in which the court stated that directors have the power to employ, fix compensation and use legitimate ends and means to retain employees or induce them to continue in the corporation's service.

no requirement that adoption of a savings and investment plan be conditioned upon stockholder approval. As stated above, employee benefits such as plans of the type under discussion relate to the internal management of the corporation, and in this area the stockholders cannot control the exercise of the directors' judgment.<sup>63</sup> In this connection the New York Court of Appeals has stated:

"As a general rule, the stockholders cannot act in relation to the ordinary business of the corporation, nor can they control the directors in the exercise of judgment vested in them by virtue of their office. . . . Directors are the exclusive, executive representatives of the corporation, and are charged with the administration of its internal affairs and the management and use of its assets."<sup>64</sup>

It is recommended that stockholder ratification of the plan be sought in the event the plan cannot be adopted without the vote of directors who will participate in the plan. Although there are some cases which hold that an interested director may be counted for quorum purposes, the majority and better view is that a director who is personally interested in a question before the directors' meeting cannot be counted for quorum purposes.<sup>65</sup> However, unless the board action is fraudulent or ultra vires, the lack of a disinterested quorum of directors may be cured by submission of the plan to stockholders. This is demonstrated by *Kerbs v. California Eastern Airways*,<sup>66</sup> which involved the validity of California Eastern Airways' stock option and profit-sharing plans. The Delaware Supreme Court, after finding that the plans were illegally adopted because the votes of interested directors were required to be counted for quorum purposes, held that stockholder action cured any voidable defect in the adoption of the plans.<sup>67</sup> The court said that the validity of the stock option plan depended "directly upon the ratification of the plan by a majority of the stock, since all the directors who adopted it were beneficiaries of the plan."<sup>68</sup>

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63. See *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954); *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918).

64. *Id.* at 323, 119 N.E. at 562.

65. See 2 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 426 (perm. ed. rev. repl. 1954) and cases cited therein.

66. 33 Del. Ch. 69, 90 A.2d 652, *reargument denied*, 33 Del. Ch. 174, 91 A.2d 62 (Sup. Ct. 1952). *Contra*, *Fountain v. Oreck's, Inc.*, 71 N.W.2d 646 (Minn. 1955), in which the Minnesota Supreme Court stated that interested directors may be counted for quorum purposes.

67. 33 Del. Ch. at 73, 90 A.2d at 655.

68. *Id.* at 176, 91 A.2d at 63. It is difficult to reconcile the Delaware Supreme Court's holding on the question of the participation of interested directors in the *Kerbs* case with a statement of the same court on this question in *Gottlieb v. Heyden*

In addition, under a regulation of the Securities and Exchange Commission stockholder approval of the savings and investment plan would exempt from the profit-recovery provision of section 16(b) of the Securities Exchange Act of 1934 any stock acquisitions pursuant to the plan by officers and directors.<sup>69</sup>

### *Pre-emptive Rights*

An employer corporation contemplating the use of unissued stock as an investment medium in the savings and investment plan should consider the possibility of violation of the pre-emptive rights of its stockholders. Pre-emptive rights have been said to be necessary to protect the existing shareholders' rights (a) to have their voting powers unprejudiced, (b) to dividends and (c) to a distributive share of the assets on dissolution.<sup>70</sup> If there is a denial of the stockholder's preference in subscribing for new stock, he may maintain an action for damages or sue for an injunction to enforce his rights to subscribe for or purchase the stock.<sup>71</sup>

Violation of shareholders' pre-emptive rights may be avoided in several different ways. Of course, there would be no violation of pre-emptive rights if the employer company or the trustee purchased the employer's stock for the plan in the open market. And it would not be contrary to those rights if treasury shares were used as an investment medium,<sup>72</sup> or the charter contained a general exemption

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Chemical Corp., 33 Del. Ch. 177, 91 A.2d 57 (Sup. Ct. 1952). In the *Gottlieb* case the court said, "We understand that where the board members vote themselves stock options and do not obtain stockholder ratification, they themselves have assumed the burden of proving their utmost good faith and the most scrupulous inherent fairness of the bargain. . . . Where there is stockholder ratification, however, the burden of proof is shifted to the objector." *Id.* at 178, 91 A.2d at 58. Although a majority of the directors of Heyden Chemical Company were eligible to participate in the stock option plan, the Delaware Supreme Court did not say that the validity of the board's action depended on stockholder ratification; indeed, it appears to have held that the action by a majority of interested directors in adopting the option plan was valid, but that in an attack of the plan the directors would have the burden of proving their good faith and the inherent fairness of the bargain.

The presence and vote of an interested director does not invalidate the action if there was a quorum without him, and the necessary majority vote in favor of the resolution or act was obtained without counting his vote. See 2 FLETCHER, *op. cit. supra* note 65, § 426 (1931) and cases cited therein. Moreover, the personal interest of shareholders does not restrict their voting as shareholders with respect to the matter in which they have an interest. See BALLANTINE, CORPORATIONS 177 (rev. ed. 1946).

69. See text at notes 192-95 *infra*.

70. See Drinker, *The Preemptive Rights of Shareholders To Subscribe to New Shares*, 43 HARV. L. REV. 586 (1930).

71. 11 FLETCHER, CYCLOPEDIA OF CORPORATIONS § 5141 (perm. ed. 1932). The statutes of certain states deny stockholders pre-emptive rights unless otherwise provided in the articles of incorporation. *E.g.*, CAL. CORP. CODE ANN. § 1106 (Deering 1953); PA. STAT. ANN. tit. 15, § 2852-611 (Purdon 1938).

72. See BALLANTINE, CORPORATIONS 490-91 (rev. ed. 1946); Annots., 138 A.L.R. 526, 535 (1942); 52 A.L.R. 220, 236 (1928).

from pre-emptive rights or exempted from these rights securities issued to employees.

Moreover, it may be possible under state court decisions or statutes to amend a corporate charter that does not presently exempt from pre-emptive rights stock issued to employees. Decisions of the Delaware Court of Chancery and the Delaware Supreme Court in the case of *Gottlieb v. Heyden Chemical Corp.*<sup>73</sup> have made it clear that a Delaware corporation may so amend its charter. In that case, which involved the validity of Heyden's stock option plan, the Delaware Supreme Court agreed with the Court of Chancery that pre-emptive rights are no different from other special rights which may be legally cut off by amendment to the corporate charter under Delaware corporation law.<sup>74</sup>

Corporations in other states may find solution of the pre-emptive rights problem in specific statutory coverage. A number of states have adopted laws providing for the establishment of stock purchase plans under which employees may purchase the employer's unissued stock directly or through a trustee on their behalf.<sup>75</sup> It should be noted, however, that usually these laws require the approval of the stockholders. For example, under the New York law the plan must either be consented to in writing by all of the stockholders or approved by a majority vote at a stockholders' meeting. Any dissenting stockholder who meets certain procedural requirements has appraisal rights.<sup>76</sup>

#### *Rules Against Perpetuities, Accumulations and Restraints on Alienation*

A large number of states<sup>77</sup> have enacted legislation exempting trusts established under different types of employee benefit plans from

73. 32 Del. Ch. 231, 83 A.2d 595 (Ch. 1951), *rev'd on other grounds*, 33 Del. Ch. 283, 92 A.2d 594 (Sup. Ct. 1953).

74. See DEL. CODE ANN. tit. 8, § 242 (1953).

75. CAL. CORP. CODE ANN. § 1108 (Deering 1953); COLO. REV. STAT. ANN. § 31-2-18(1) (1953); IDAHO CODE ANN. § 30-120(7) (1947); ILL. ANN. STAT. c. 32, § 157.24 (Smith-Hurd 1953); MICH. COMP. LAWS § 450.24 (1948); N.J. REV. STAT. § 14:9-1 (1937); N.M. STAT. ANN. § 51-3-13 (1953); N.Y. STOCK CORP. LAW § 14; OHIO REV. CODE ANN. § 1701.41 (Baldwin 1956); PA. STAT. ANN. tit. 15, § 138 (Purdon Supp. 1955); PA. STAT. ANN. tit. 15, § 2852-611 (Purdon 1938). A somewhat similar statute in Massachusetts apparently applies only to a limited class of corporations: MASS. ANN. LAWS c. 158, §§ 26-28 (1948); see also MASS. ANN. LAWS c. 110A, §§ 11A, 11E (1954). The question may be raised of whether directors and officers are employees within the meaning of these statutes. It has been said that these statutes are probably broad enough to include directors "actively engaged" in the conduct of the business and executive officers. WASHINGTON & ROTHSCHILD, COMPENSATING THE CORPORATE EXECUTIVE 127 (1951).

76. N.Y. STOCK CORP. LAW § 14. See also CAL. CORP. CODE ANN. § 1108 (Deering 1953).

77. Included among the state laws which exempt trusts created by an employer as part of a stock bonus, pension, disability, death benefit or profit-sharing plan from

the various rules against perpetuities,<sup>78</sup> accumulations of income,<sup>79</sup> and unreasonable restraints on alienation.<sup>80</sup> These laws preclude any possibility of a court holding trusts of that kind void for being in violation of one of the rules.

Careful study should be made of the applicable statute, however, to ascertain whether it covers savings and investment plans, for not all of the state laws appear to exempt trusts created under such plans from the above-mentioned rules. For example, the statute of California<sup>81</sup> contains specific exemption from those rules only as to

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the various rules against perpetuities, accumulation of income and restraints on alienation are the following: CONN. GEN. STAT. § 6898 (1949); ILL. ANN. STAT. c. 30, § 153 (Smith-Hurd Supp. 1955); ILL. ANN. STAT. c. 48, § 39t (Smith-Hurd 1950); IND. ANN. STAT. §§ 51-111 to 12 (Burns 1951); ME. REV. STAT. ANN. c. 160, § 22 (1954); MO. REV. STAT. §§ 456.060-70 (1949); OHIO REV. CODE ANN. § 2131.09 (Baldwin 1956); PA. STAT. ANN. tit. 20, §§ 3261-62 (Purdon Supp. 1955); TENN. CODE ANN. § 35-609 (Supp. 1955); see also DEL. CODE ANN. tit. 35, § 503 (1953); N.Y. PERS. PROP. LAW § 13-c (the Delaware and New York laws do not specify an exemption from any law against accumulation of income); LA. REV. STAT. § 9:1794 (1950) (the Louisiana statute exempts any trusts created by employers for the benefit of employees). The various applicable state laws are quoted in CCH PENSION PLAN GUIDE ¶ 1116 (1955).

*Query:* Is a savings and investment plan either a stock bonus or profit-sharing plan within the intent of the above statutes? It is believed the answer should be in the affirmative. As pointed out in discussion on taxes, such plans may qualify as stock bonus or profit-sharing plans for federal income tax purposes. See text at notes 97 and 98 *infra*.

78. Under the so-called common-law rule against perpetuities, no interest is good unless it must vest, if at all, not later than twenty-one years after some life, or lives, in being at the creation of the interest. *E.g.*, Sahlender Estate, 89 Cal. App. 2d 329, 201 P.2d 69 (App. Dep't 1948); Keeler v. Lauer, 73 Kan. 388, 85 Pac. 541 (1906); McGill v. Trust Co., 94 N.J. Eq. 657, 121 Atl. 760 (Ch. 1923); see GRAY, THE RULE AGAINST PERPETUITIES § 201 (4th ed. 1942). The courts have held in the case of gifts or transfers to classes that if the interest of any potential member of a class can by any possibility vest too remotely, the entire class gift fails. *E.g.*, Taylor v. Crosson, 11 Del. Ch. 145, 98 Atl. 375 (Ch. 1916); Kountz's Estate, 213 Pa. 390, 62 Atl. 1103 (1906). It would thus appear that a trust created under a plan of the type under discussion would be void for violation of the rule in the absence of a statutory exemption, or unless the beneficiaries of the trust were limited to participants alive at the time of the trust's creation or born within twenty-one years thereafter. See Lauritzen, *Perpetuities and Pension Trusts*, 24 TAXES 519, 520 (1946).

79. Some states have enacted laws limiting the right to accumulate income. *E.g.*, ALA. CODE ANN. tit. 47, § 146 (1940) (limiting the accumulation of income by a trust to ten years except for the benefit of a minor); N.Y. PERS. PROP. LAW § 16.

80. It has been pointed out with respect to restraints on alienation as to shares of stock that while an owner of stock may enter into many transactions which have the effect of restraining transferability of the stock for temporary periods in the future, arbitrary restraints on alienation are forbidden and unless restraints are imposed for purposes recognized as sufficient, they will be held invalid. Tracey v. Franklin, 31 Del. Ch. 477, 67 A.2d 56 (Sup. Ct. 1949). In that case a voting trust agreement in which the parties agreed not to sell or transfer stock for about ten years without the consent of both parties was held invalid as an unreasonable restraint on alienability. The holding period of the short-term or periodic-distribution type plan should not be deemed an unreasonable period of restraint. In the long-term or terminal distribution type plan the public policy against restraints on alienation should be relaxed, since providing for old-age or retirement through employee benefit plans has been recognized as a proper purpose and trusts established under such plans a reasonable means of accomplishing that purpose. This clearly is indicated by the large number of states which have adopted laws exempting such trusts from the rule.

81. CAL. CORP. CODE ANN. § 28004 (Deering 1953).

trusts created as part of a pension or retirement plan. The New Jersey statute<sup>82</sup> exempts trusts created as part of plans providing "pensions during old-age, disability or unemployment or other similar aids for the relief or general welfare of any of such employees . . . ." This law probably is sufficiently broad to embrace a trust created as part of a savings or investment plan, but the language is far from clear.

Moreover, some statutes do not provide an exemption from all these various rules. It has been pointed out, for example, that although Alabama has a statutory prohibition against accumulations of trust income for more than ten years,<sup>83</sup> the Alabama statute<sup>84</sup> does not appear to exempt employee trusts from that prohibition.<sup>85</sup> The almost identical New York and Florida laws seem to contain curious omissions. Trusts created under retirement plans which are exempt from federal income tax are by provisions<sup>86</sup> of these statutes exempted from any laws against perpetuities, restraints on alienation and accumulations of income, but other provisions<sup>87</sup> exempt trusts created as part of a stock bonus and similar employee-benefit plans from all of such laws except the prohibitions against accumulations of income.

It has been suggested that in those states in which the common law rule against perpetuities, or some variation thereof, is in effect as to employee trusts, the life of the trust should be limited to a period which cannot extend beyond that prescribed by law.<sup>88</sup> The following provision, recommended to provide for the common law rule against perpetuities in a pension trust agreement, could also be used in a trust established under a savings and investment plan:

*"Duration of Trust.* Unless sooner terminated under the provisions of this Agreement, the Trust shall terminate upon the expiration of twenty-one (21) years after the death of the last to survive of those persons becoming individual trustees and/or participating employees hereunder as of the effective date of this Trust. . . ." <sup>89</sup>

The above provision would require the establishment of new trusts as other employees participate in the plan. But it has been pointed out

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82. N.J. STAT. ANN. § 14:9-6, 7 (1939).

83. ALA. CODE ANN. tit. 47, § 146 (1940).

84. ALA. CODE ANN. tit. 47, § 152.1 (Supp. 1955).

85. Lauritzen, *supra* note 78, at 523.

86. FLA. STAT. § 441.02 (Supp. 1955); N.Y. PERS. PROP. LAW § 13-d.

87. FLA. STAT. § 441.01 (Supp. 1955); N.Y. PERS. PROP. LAW § 13-c.

88. CCH PENSION PLAN GUIDE ¶ 1117 (1956).

89. *Ibid.*

that, subject to applicable state law concerning common trust funds, the assets of the various trusts could be treated as a common trust fund so that all assets could be administered together.<sup>90</sup> Appropriate modification in the suggested provision should, of course, be made if the common-law rule against perpetuities has been changed by statute. And if appropriate in the particular state involved, the trust agreement should also provide against possible violations of prohibitions against accumulations of income and unreasonable restraints on alienation.

#### FEDERAL TAX ASPECTS

In setting up an employee savings and investment plan which contemplates employer contributions, the tax consequences to both the employer and his employees must be carefully explored. The desired objectives, aside from minimizing tax liability to all concerned, should be to make it possible for the employer to obtain a tax deduction in the year in which contributions are made under the plan, and to make sure that the employees will not be taxed until the year in which they receive payment.

A plan calling for payments in the future may be currently funded by an employer, or obligations incurred may be paid only as benefits are due employees. From a tax standpoint a funded plan which qualifies as a stock bonus, pension or profit-sharing plan within the meaning of section 401 of the Internal Revenue Code of 1954 has distinct advantages. Use of a funded plan which does not so qualify can almost never be recommended. Where no deferment of income is desired, where cash is the intended benefit to the employee, or where only a small number of supervising employees are to be benefited, there may be no need to fund a plan. It seems almost beyond argument, however, that an employee savings plan which is intended to benefit a large group of employees is best implemented by use of a qualified plan and trust.

#### *Requisites of Qualified Plan and Trust*

A trust that is qualified under section 401 has definite tax advantages. It is exempt from income tax.<sup>91</sup> Contributions to the trust by an employer are, within certain limits, deductible in the year in which made.<sup>92</sup> The beneficiaries of such trusts, aside from other

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90. *Ibid.*

91. INT. REV. CODE OF 1954, § 501(a). See *id.* § 503 for denial of exemption where "prohibited transactions" have been engaged in after March 1, 1954, and *id.* § 511 for imposition of tax on "unrelated business income" of an employee's trust.

92. *Id.* § 404.

substantive tax advantages, are not taxed on the employer's contributions prior to the year in which distributions are made available to them.<sup>93</sup> A trust which is not so qualified, on the other hand, is subject to income tax; contributions to it are not deductible by the employer unless each employee's rights are nonforfeitable at the time of contribution;<sup>94</sup> and an employee may be taxed in the year of contribution because he has a nonforfeitable right even though there is no possibility that he will receive anything in that year.<sup>95</sup>

The requirements for qualification of a plan and employees' trust are specifically set out in section 401. First, a plan must be a pension, profit-sharing or stock bonus plan.<sup>96</sup> The statute does not define these terms but under Treasury Department Regulations interpreting the 1954 Code a pension plan is defined as one which is established and maintained primarily to provide systematically for the payment of definitely determinable benefits over a period of years, usually for life, after retirement. The benefits must not be dependent upon the employer's profits, and the employer's contributions must generally be determinable actuarially, on the basis of definitely determinable benefits.<sup>97</sup> A profit-sharing plan is defined as one which is established and maintained by an employer to provide for participation in his profits by his employees or their beneficiaries. The plan must provide a definite predetermined formula for allocating contributions made thereunder among participants, and for distributing funds on the happening of some future event. A stock bonus plan is defined as one which is established and maintained to provide benefits similar to those of a profit-sharing plan, except that contributions by the employer are not necessarily dependent upon profits and benefits are distributable in stock of the employer. Unless a plan can properly be classified as a pension,

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93. *Id.* § 402(a).

94. *Id.* § 404(a)(5). The test of nonforfeitability is applied on an individual basis rather than for employees as a class. Thus, if an irrevocable contribution to a trust is made by an employer for the sole benefit of his employees generally, no tax deduction will be allowed unless each individual employee's credit is nonforfeitable at the time of contribution. Jacob Lichter, 17 T.C. 1111, *aff'd per curiam*, 201 F.2d 49 (6th Cir. 1952), *cert. denied*, 345 U.S. 943 (1953); William M. Bailey Co., 15 T.C. 468 (1950), *aff'd per curiam*, 192 F.2d 574 (3d Cir. 1951); Times Publishing Co., 13 T.C. 329 (1949), *aff'd per curiam*, 184 F.2d 376 (3d Cir. 1950).

95. E. T. Sproull, 16 T.C. 244 (1951), *aff'd*, 194 F.2d 541 (6th Cir. 1952); J. H. McEwen, 6 T.C. 1018 (1946).

96. INT. REV. CODE OF 1954, § 404 governs deductions only where deferral of compensation is involved. In order to obtain a tax deduction for forfeitable deferred compensation prior to actual payment to the employee, it must be made to a trust established under a qualified stock bonus, pension or profit-sharing plan. Contributions to a trust established for reasons other than to defer compensation may be deductible under other sections of the law. T. J. Moss Tie Co., 18 T.C. 188 (1952) (treating contributions to a trust for benefit of needy employees as a deductible charitable contribution); Rev. Rul. 102, 1956 INT. REV. BULL. No. 12, at 5 (dealing with trusts established to provide supplemental unemployment benefits).

97. See U.S. TREAS. REG. § 1.401-1(b).



profit-sharing or stock bonus plan within these definitions, it cannot qualify for special tax treatment.

A savings and investment plan could not ordinarily be set up as a pension plan.<sup>98</sup> However, if it is geared to profits, it could be qualified as a profit-sharing plan or, if benefits are paid in the employer's stock, it would constitute a stock bonus plan. An administrative ruling of particular pertinence to this type of plan should be carefully observed. The Internal Revenue Service has held that a plan which permits an employee to withdraw any portion of his share of an employer's contribution within two years after it has been made and without regard to the attainment of a stated age or the occurrence of some event such as illness, disability, retirement, death or severance of employment is not a profit-sharing plan.<sup>99</sup> For the purpose of allocating and distributing the stock of the employer among employees, a stock bonus plan is subject to the same requirement as a profit-sharing plan.<sup>100</sup>

More important is the requirement that the plan must not discriminate in favor of officers, stockholders, supervisors or highly compensated employees, either as to eligibility for or amount of benefits. No question will be raised as to discrimination in eligibility if the plan benefits at least seventy per cent of all the employees or, provided at least seventy per cent of the employees are eligible for benefits, it covers eighty per cent of those eligible. In determining the total number of employees for this test, part-time and seasonal employees and employees with less than five years of service may be ignored. If this test cannot be met, the plan will still qualify if the Internal Revenue Service determines that the prohibited discrimination does not, in fact, exist. By statute a plan will not be considered discriminatory merely because it is limited to salaried employees, or merely because it excludes all employees receiving less than \$4,200 a year (the maximum amount subject to the federal insurance contributions tax), or because the amount of wages subject to the federal insurance contributions tax is not counted in determining the amount of benefits.<sup>101</sup>

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98. Qualification as a pension plan rather than a stock bonus or profit-sharing plan would be important because of the difference in limitations on allowable contributions. See INT. REV. CODE OF 1954, § 404(a).

99. Rev. Rul. 231, 1954-1 CUM. BULL. 150.

100. U.S. TREAS. REG. § 1.401-1(b)(1)(iii).

101. INT. REV. CODE OF 1954, § 401(a)(5). For a comprehensive discussion of the whole subject of discrimination with references to pertinent prior law, see Gordon, *Discrimination Problems in the Drafting and in the Operation of Pension and Profit Sharing Plans*, N.Y.U. 14TH INST. ON FED. TAX. 1153 (1956).

The nature of employee savings and investment plans will ordinarily demand a wide participation so that all employees having a certain amount of service will be eligible to participate. In any event the classification of those eligible should not be discriminatory. Further, under the ordinary plan there will be no difficulty in showing that contributions or benefits do not discriminate in favor of officers, stockholders, supervisors or highly compensated employees. If benefits are payable to all participants on the same terms, no problem of discrimination should arise. However, if a plan allows only employees saving a certain amount to elect to defer receipt of all benefits until retirement and to take all benefits in a lump sum at that time, the Internal Revenue Service might contend that the plan is discriminating because it favors the highly compensated employees.

Another requirement for qualification is that the plan must be intended to be permanent, although there is no restriction on the employer's reserving the right to terminate the plan should he wish to do so in the future. Not only is this test a subjective one, but it is apparently applied very loosely. For example, a pension plan covered by a bargaining agreement with a union which runs for only five years is regarded as meeting the permanency test.<sup>102</sup> It would seem that any plan will meet this test unless it is obviously intended as a temporary program which is not primarily designed to benefit the employees in general, but rather to benefit the key employees. Early termination of a plan will be deemed by Internal Revenue authorities to be evidence that the plan was not intended to be permanent, unless it can be shown that the termination was justified by conditions not foreseen when the plan was instituted.<sup>103</sup>

A plan must be for the exclusive benefit of employees or their beneficiaries. For example, it cannot cover stockholders as such. This requirement must be met not only by the form of the plan but also in its operation. Thus, if a trust fund is set up in connection with the plan, the fund must not be used or manipulated in such a manner as to benefit the employer. As a matter of fact, this seemingly simple requirement has been the subject of a large number of rulings by the

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102. PS No. 67, reported in 5 CCH 1951 STAND. FED. TAX REP. ¶6122. See also *Lincoln Elec. Co. Employees' Profit-Sharing Trust v. Commissioner*, 190 F.2d 326 (6th Cir. 1951), where a profit-sharing plan was held to be permanent even though the employer was not required to make any contribution after the first one.

103. Mimeograph 6136, 1947-1 CUM. BULL. 58. A plan which is set up during years of high tax rates and is abandoned without a valid business reason when profits fall off is not a permanent plan which will be held to be qualified. Rev. Rul. 33, 1953-1 CUM. BULL. 267, 271. When a plan which has been in existence more than ten years is terminated because of adverse business conditions, no statutory discriminations which could result in retroactive disqualification is possible. Rev. Rul. 60, 1955-1 CUM. BULL. 37.

Internal Revenue Service covering many situations in which question arose as to whether the plan was being utilized in some degree for the financial benefit of the employer.<sup>104</sup>

A corollary requirement is that if a trust is set up as a part of the plan, it must be impossible under the trust instrument for any part of the trust funds to be recaptured by the employer or used for any purpose other than the exclusive benefit of the employees or their beneficiaries until all liabilities under the plan to the employees or their beneficiaries have been satisfied. The regulations interpret this provision to cover not only liabilities with respect to benefits that have become vested in employees but also potential liabilities for benefits which may never, in fact, become payable; and they hold that an employer can recover from the trust only the amount which, after satisfaction of all these liabilities, remains in the trust because of actuarial errors.<sup>105</sup> This interpretation of the law appears somewhat dubious, but is likely to be only an academic matter for most companies.

### *Tax Considerations of the Employer*

#### Qualified Plan and Trust

If a stock bonus or profit-sharing plan is qualified so that the trust is exempt from tax, then the employer's contributions to the trust will be deductible for federal income tax purposes in the year in which they are made to the extent of fifteen per cent of the compensation otherwise paid or accrued during the year to all employees who participate in the plan.<sup>106</sup> This limit will rarely have any effect on an employee savings and investment plan. If contributions are made during the year to two or more stock bonus or profit-sharing trusts, such trusts will be considered as one for purposes of applying the limitations.

If a qualified trust is established, amounts paid by the trust to participating employees will not be considered "wages" for withholding tax purposes.<sup>107</sup> However, whether the trustee would be required to file information returns showing the names of employees who were paid in excess of \$600 during a taxable year is in doubt. Under the law prior to 1954 such a return would have been required.<sup>108</sup> In

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104. I.T. 4020, 1950-2 CUM. BULL. 61 (the effect of stockholder participation); I.T. 3268, 1939-1 CUM. BULL. 196 (dealing with an employer as a beneficiary under a plan); Rev. Rul. 398, 1954-2 CUM. BULL. 239 (designation of beneficiaries); Rev. Rul. 46, 1953-1 CUM. BULL. 287 (investment of trust funds).

105. See U.S. TREAS. REG. § 1.401-2(b).

106. INT. REV. CODE OF 1954, § 404(a)(3).

107. *Id.* § 3401(a)(12).

108. *Id.* § 147(a).

1954 the law was changed to provide that only persons engaged in a trade or business need file such information.<sup>109</sup> While a trustee would not ordinarily, when acting in his trust capacity, be considered as engaged in a trade or business, the Internal Revenue Service has ruled that even under the 1954 Code trustees for employee's trusts must file information returns.<sup>110</sup> The requirement is probably not important in the case of most savings and investment plans, since taxable distributions by the trust in one year would seldom exceed \$600 to any one employee.

### Nonqualified Plans

In most situations a plan of the type under discussion may best be implemented by an employer through use of a tax qualified trust. However, special circumstances may make it impractical or impossible to qualify a plan. Three such situations immediately come to mind. In cases where it is desired to reward employees for their thrift annually, there is no need even to consider a trust. Employees' savings can be deducted and deposited during the year in some neutral account. At the end of the year the employer could pay benefits based on the amount of savings and possibly on the length of time during which such savings accumulated. The employer's payments, whether in stock or cash, would be tax deductible by him and taxable to the employee just as are any other wages.

If cash is the desired benefit, a plan can be qualified only if the employer's contribution is based on profits, so that the plan may be classified as a profit-sharing plan. If the plan provides for a deferral of compensation but is not a pension, profit-sharing or stock bonus plan, an irrevocable trust established under the plan will not be exempt from tax and the employer's payments to such a trust will be deductible only to the extent that each individual participating employee's rights to such payments are nonforfeitable at the time of payment.<sup>111</sup> However, if the employee's interest is nonforfeitable at the time of contribution so that tax deduction is allowable, the employee will be required to pay tax on an amount which he has not then received.<sup>112</sup> Because of these factors it will be of advantage in only a very few

109. *Id.* § 6041(a).

110. Int. Rev. Serv. Release No. 095, reported in CODE VOL. CCH STAND. FED. TAX REP. ¶ 37097 (1955).

111. See text at note 94 *supra*. The Internal Revenue Service has ruled that where a corporation sets up a revocable trust to act as the custodian of deferred compensation bonus funds, which are to be paid only to key employees, income of the trust is taxable to the corporation and the corporation may deduct payments as they are made from the trust. Rev. Rul. 525, 1955-2 CUM. BULL. 543.

112. INT. REV. CODE OF 1954, § 402(b).

instances to set up a trust for the payment of nonprofit-sharing cash in any way other than as a pension. If cash is to be the benefit and payment is to be deferred, then provision should be made for direct payments to the employees by the employer and the employee's rights to any benefit should be forfeitable at all times prior to payment.

In cases where only a small number of employees are to be covered by the plan, it will be possible to qualify it only if the classification of beneficiaries is not discriminatory in favor of supervisory or highly paid employees. Therefore, if it is intended to limit benefits to key employees, a contributory stock purchase plan without use of a trust may provide the best tax results. Such a plan could be set up so that after a specified period or amount of employee savings, the employer would pay enough cash to complete the stock purchase. If it is desired to tie the plan to profits, the employer's annual commitment could be based on a profit-sharing formula but payment could be deferred from year to year as employee's accounts increased. However, a tax deduction will be allowed only in the year in which the contribution is paid even though the employer is on the accrual basis.<sup>113</sup>

In almost all but these three specific cases, the qualified plan affords the best and, in fact, the only acceptable tax consequences to the employer. Such a plan provides the only sure method of true deferment of compensation. Moreover, if qualifying an employee savings plan is of tax advantage to an employer, it is doubly so to the participating employee.

### *Tax Considerations of Employees*

Beneficiaries of a qualified employee's trust are taxed on distributions from the trust only in the year of distribution or when amounts are "made available" to them.<sup>114</sup> An employee realizes no taxable income when such a trust distributes to him stock which has been purchased with his contributions, even though the value of the stock at such time exceeds the amount paid for it.<sup>115</sup> If all of an employee's share from a trust is paid in one taxable year because of death or other separation from the employer's service, the amount is taxable as a long-term capital gain.<sup>116</sup> If stock or securities of the employer are so distributed, the employee will be taxed only to the extent of the trust's tax basis of the stock if that is lower than fair market value. Distributions from a qualified trust to the estate or

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113. *Id.* § 404(a) (5).

114. *Id.* § 402(a) (1).

115. *Id.* § 402(a) (2).

116. *Ibid.*

beneficiary of an employee by reason of his death will be subject to the \$5,000 death benefits exemption even though the employee may have had a nonforfeitable interest prior to his death.<sup>117</sup> In addition, amounts distributable from a qualified trust, except to the extent such amounts are attributable to the employee's contributions, are not included in the gross estate of a decedent if such amounts are receivable by any beneficiary other than his executor.<sup>118</sup>

On the other hand, benefits paid directly to an employee or by means of a trust which is not part of a qualified stock bonus, pension or profit-sharing plan will be taxed at fair market value either when payment is made or when the employee's rights become nonforfeitable. The possibilities of obtaining capital gain treatment of compensation, other than through use of a qualified trust, are very remote.

While the basic rules governing the taxability of employees receiving benefits from a qualified trust are explicit, there are some pitfalls. The law provides that an employee will be taxed when an amount is "made available" to him. The Internal Revenue Service, in 1955, published three rulings which set out conditions under which amounts would be considered to have been made available and subject to tax even though no amount had actually been received by the employee. These make it clear that so long as there are substantial conditions or restrictions on an employee's right of withdrawal, he will not be taxed prior to actual receipt. Thus, if an employee may withdraw amounts attributable to his savings, but as a result cannot participate in the plan for a period of a year or must forfeit part of the amount, no amount is "made available" to him until actual receipt.<sup>119</sup> If the plan

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117. *Id.* § 101(b).

118. *Id.* § 2039(c).

119. Rev. Rul. 423, 1955-1 CUM. BULL. 41. This ruling should be compared with Rev. Rul. 265, 1954-2 CUM. BULL. 239, dealing with a profit-sharing plan which provided that distribution from a trust would be made to a participant on termination of service in installments computed on the basis of his life expectancy unless the employee elected to receive a lump sum distribution after fifteen years of participation in the plan, which election could be made only after 14½ years but at least thirty days prior to the date on which termination was effective. It was held that the lump sum amount was made available and was taxable to the employee after fifteen years of participation even though he did not elect to receive it so that he was actually paid in annual installments on termination. It was stated that an amount becomes available to an employee when he first acquires an unrestricted right to withdraw. Since the only bar to actual receipt was the failure to request payment which was a condition of no real substance, the employee was taxable on the lump sum amount after fifteen years of participation.

Rev. Rul. 55-423 provides that so long as an employee's election to defer is irrevocable and must be exercised prior to the time his interest becomes distributable, it is immaterial whether the exercise of the election takes the form of positive action or merely inaction on the part of the employee. While Rev. Rul. 54-265 is cited as support for the proposition that conditions upon withdrawal which are without substance will not prevent a participant's interest from being made available, it is submitted that the two rulings can only be reconciled on the grounds that the election to take in Rev. Rul. 54-265 could be made after the employee's interest became distributable so that

provides that prior to the time his interest becomes distributable an employee can make an irrevocable election to have the distribution to him deferred to a future time, the employee will be taxed only as he receives a distribution.<sup>120</sup> Further, if an employee may elect after a period of participation to withdraw a part of the full amount standing to his credit but only after the approval of an administrative committee in case of proved financial necessity, the amounts will not be deemed to be "made available" until actual receipt.<sup>121</sup>

### Exclusion of Net Unrealized Appreciation

In any case in which the employer's securities are distributed or made available to participating employees under a qualified plan, it is necessary to be able to determine the amount which the securities have appreciated since their purchase by the trust. This amount, to the extent it can be attributed to the employee's contribution, will not be taxed to the employee at the time he receives the stock. Such amount, of course, will be the difference between the trust basis for the stock and its fair market value at time of delivery. The Internal Revenue Service has set out specific rules which should be helpful in determining the cost of such securities to the trust.<sup>122</sup> Of course, if the trust purchases stock and immediately earmarks it for an employee's account, the stock has a readily determinable cost basis. And, if the trust acquires stock during a year and allocates it only at year-end, the basis is determined by taking the average cost of the shares. More difficult is the case where stock is purchased monthly with the employee's and employer's contributions and is then allocated on a partial share basis to employee's accounts. Although it is not clear, it would seem that the basis to the trust for employee distribution purposes should be the cumulative total of the cost of the partial shares which go toward making up a whole share.

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the employees were in constructive receipt at the time when they could have taken the lump sum. It seems clear that if, in Rev. Rul. 54-265, the election to take in a lump sum had to be made prior to fifteen years of participation, the principles of Rev. Rul. 55-423 would apply to prevent taxation of the lump sum if no such election were made. In this regard the two rulings are in conflict under a specific situation which could arise under Rev. Rul. 54-265. If under the plan considered therein the employee was terminated exactly on the anniversary of his fifteenth year of service without having exercised his election, it should follow from Rev. Rul. 55-423 that no amount was ever made available to him prior to actual distribution since the lump sum amount never became distributable to him. The distinction based on the time of election is one which has previously been made in considering endowment options contained in life insurance contracts. *Blum v. Higgins*, 150 F.2d 471 (2d Cir. 1945). See also I.T. 3963, 1949-2 CUM. BULL. 36.

120. Rev. Rul. 425, 1955-1 CUM. BULL. 43.

121. Rev. Rul. 424, 1955-1 CUM. BULL. 42.

122. Rev. Rul. 354, 1955-1 CUM. BULL. 396.

Net unrealized appreciation is important also where an employee or his beneficiary receives the total distribution of his credits from the trust in one taxable year because of his separation from the service of the employer. In such a case the net unrealized appreciation of employer securities which are distributed will not be taxed until they are sold by the employee. The lump sum distribution, to the extent it exceeds employee contributions reduced by prior distributions not included in the gross income of the employee, will be taxed as a gain from the sale or exchange of a capital asset held for more than six months.<sup>123</sup> The employee's basis for any securities so received will be the same as the trust's basis for purposes of computing gain or loss on his disposition of the securities. An amount received as a lump sum in one taxable year from an employee's trust is taxed at capital gains rates only if it is clear that the reason for the payment was the employee's separation from service. The receipt of his entire retirement credits in one year will not be taxable as capital gain if the employee continues to draw regular salary.<sup>124</sup> And the Internal Revenue Service will probably contend that a complete distribution from an exempt trust, which is caused by a change in the corporate structure of the employer or upon discontinuance of the trust plan, should be taxed as ordinary income if the employee continues in the employ of the reorganized corporation.<sup>125</sup>

The advantage of deferring tax on appreciation attributable to their contributions may be lost if, under the plan, employees are allowed the option to change the nature of the investments credited to their accounts. Many existing employee savings and investment plans allow an employee the right to switch investments annually between employer stock, government bonds or some other specified stock or security. The Internal Revenue Service has held that, where an employee elects to convert his investments from employer stock to another investment, he loses the tax advantage of excluding from taxable income the net unrealized appreciation up to the date of conversion even though he may later reinvest in employer stock.<sup>126</sup>

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123. INT. REV. CODE OF 1954, § 402(a) (2).

124. *Fry's Estate v. Commissioner*, 205 F.2d 517 (3d Cir. 1953).

125. INT. REV. CODE OF 1954, § 402(e) provides that a distribution made during the calendar year 1954 as a result of the complete termination of a plan, if the termination is incident to the complete termination of the company before August 1954, will be a distribution on account of separation from service whether or not the liquidation is incident to a statutory reorganization. This provision was adopted to avoid hardships "in the case of certain plans which it is understood were terminated on the basis of mistaken assumptions regarding the application of present law." S. REP. NO. 1622, 83d Cong., 2d Sess. 54 (1954); cf. *Mary Miller*, 22 T.C. 293 (1954), *aff'd*, 226 F.2d 618 (6th Cir. 1955).

126. Rev. Rul. 354, 1955-1 CUM. BULL. 396.



## Nonqualified Plans

The certainty of tax consequences which can be asserted with reference to distributions from a qualified trust is not present in determining the tax of beneficiaries of nonqualified trusts or recipients of corporate promises to pay compensation in the future. It is clear that a beneficiary of a nonexempt trust will not be taxed prior to the time when his rights become nonforfeitable.<sup>127</sup> And it is definite that he will be taxed at such time on the full amount credited to him even though he cannot reduce it to his possession for some time.<sup>128</sup> The obvious difficulty arises from determining when an employee's interest becomes nonforfeitable.<sup>129</sup> The company and the employee will have conflicting tax interests, since it will be to the employer's advantage to show that the amount is nonforfeitable at the time of contribution while the employee will surely want to postpone tax at least until actual receipt.

Even more uncertainty and greater possibility of dispute arise should the company make an unconditional promise to pay an amount in the future. While at the present time there is no court decision which would support an attempt by Internal Revenue to assert a tax based on the cash equivalent theory when the employee's right became nonforfeitable,<sup>130</sup> decisions in other closely related cases are difficult to distinguish.<sup>131</sup> If an employee's rights are forfeitable up until the date of actual receipt, tax will apply only at that time.

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127. INT. REV. CODE OF 1954, § 402(b); see Harold G. Perkins, 8 T.C. 1051 (1947); Julian Robertson, 6 T.C. 1060 (1946).

128. Percy S. Lyon, 23 T.C. 187 (1954); E. T. Sproull, 16 T.C. 244 (1951).

129. See Julian Robertson, 6 T.C. 1060 (1946).

130. The cash equivalent or economic benefit theory of income taxation has been asserted by Internal Revenue to tax an employee on the present value of a future interest created for him by an employer. It was quoted with approval in *Commissioner v. Smith*, 324 U.S. 177, 181 (1945). For comprehensive consideration see Allison, *Executives' Pensions Without Section 165*, N.Y.U. 8TH INST. ON FED. TAX. 451 (1950); Eisenstein, *A Case of Deferred Compensation*, 4 TAX L. REV. 391 (1949); Wentz, *Remedying the Effect of Taxation on Management Ownership of Corporate Stock*, 48 Nw. U.L. REV. 442 (1953).

131. The courts have almost unanimously held that an employee realizes taxable income on the cash equivalent theory at the time his employer purchases for or transfers to him a commercial retirement annuity policy if his rights at that time are nonforfeitable except by death even though the policy carries no cash surrender or loan values. *Morse v. Commissioner*, 202 F.2d 69 (2d Cir. 1953); *Ward v. Commissioner*, 159 F.2d 502 (2d Cir. 1947); *Hackett v. Commissioner*, 159 F.2d 121 (1st Cir. 1946); *Oberwinder v. Commissioner*, 147 F.2d 255 (8th Cir. 1945); *Renton K. Brodie*, 1 T.C. 275 (1942). For a comment on the *Morse* case see Seidle, *The Morse Case, Taxation Neutralizes a Retirement Program*, 31 TAXES 350 (1953). If these cases are sound it would appear that the promise of a large solvent employer to pay compensation in the future would be of as much value as the promise of an insurance company. *But see Frederick John Wolfe*, 8 T.C. 689 (1947), *aff'd*, 170 F.2d 73 (9th Cir. 1948), where the Tax Court distinguished the insurance annuity cases in holding that a promise of Standard Oil Co. (N.J.) to pay amounts in the future did not result in tax to the employee prior to actual receipt.

Aside from the most objectionable feature of taxation prior to actual receipt which may arise from the use of nonexempt trusts or straight deferral of income by an employer, the possibility of obtaining capital gain treatment for compensation is completely absent. Likewise there is no way, other than by use of a qualified trust, in which stock in the employing corporation can be transferred to an employee in a year subsequent to the year of purchase for him so that he will be taxed at the lower of cost or market value at time of transfer.

### Tax Advantages of Qualified Plans

The advantages of a qualified trust can best be appreciated by reference to a given fact situation. Suppose an employee paying tax on his ordinary compensation at an effective rate of fifty per cent saves \$1,000 a year for the purchase of stock of his employer corporation under a plan which provides that the employer will contribute fifty per cent or \$500 annually for his account in a qualified trust. Assume the stock is purchased at a cost of \$100 per share so that fifteen shares are purchased for his account in the trust. Suppose also that this stock is worth \$200 a share when the entire amount of his credit in the trust is distributed to him in the taxable year following his separation from the employer's service. At time of receipt of this one year's savings and reward, the employee will receive fifteen shares of stock worth \$3,000. He will pay no tax on the receipt of ten shares since that number is attributed to his contribution, and appreciation is not taxed to him. He will pay tax on the \$500 contributed by the employer at a maximum rate of twenty-five per cent or \$125. If his income is not high enough in that year to make the alternative tax effective,<sup>132</sup> he will include \$250 in his ordinary income and his tax will be less than \$125 depending on his effective tax rate.

The comparative tax consequences of payment of the same amount of compensation in other ways illustrates the tax saving which may be affected by use of a qualified trust. If the \$500 were contributed by the employer to a nonqualified trust or invested by him in stock which was held for the employee on a forfeitable basis, tax at ordinary rates would be imposed on the fair market value of the stock at time of delivery. Thus, appreciation after purchase of the stock would be taxed as ordinary income. Tax in such case would be at ordinary rates on \$2,000. Even the withholding tax on such amount would be \$360, or almost three times the maximum tax applicable to the qualified

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132. If taxable income after all allowable deductions and exemptions is less than \$18,000 in the case of a single individual, or \$36,000 in the case of a married couple filing a joint return, the effective tax rate on the full amount of capital gain will ordinarily be less than 25%. See INT. REV. CODE OF 1954, §§ 1, 1201(b).

trust distribution. If the \$500 were paid directly to the employee rather than contributed to the qualified trust, the employee's tax would be exactly twice the amount of the maximum tax applicable to the trust distribution. Participants would realize additional savings because, on distribution from the trust, income earned on the employer's contributions would also be taxed at capital gains rates.

While employee's savings and investment plans originally were inspired by a desire of employers to encourage thrift on the part of employees, such plans afford a sure way of deferring compensation for executives if a qualified trust is used. The possibilities in the area of executive compensation should not be ignored in instrumenting such a plan. Because the cost to the company is scaled to the employee's willingness to save, a qualified savings and investment plan should usually result in a lower cost than a noncontributory qualified stock bonus or profit-sharing plan which requires contributions by the employer at a fixed rate to be distributed to all employees. Tax-wise a qualified savings and investment plan affords a degree of certainty and advantage to all concerned which cannot be matched by other methods of payment of compensation.

#### STATUTORY REGULATION

A number of problems under federal and state regulatory statutes confront the employer corporation contemplating the offer to its employees of a savings and investment plan. An important question here is whether the securities offered to employees under the plan will have to be registered under the Securities Act of 1933.<sup>133</sup> Other problems involve various disclosures about the adoption and administration of the plan under requirements of the Securities Exchange Act of 1934,<sup>134</sup> the effect of state blue sky laws, the impact of treasury regulations with respect to drafting and operating the plan in the event United States Government bonds are used as an investment medium, and wage and bargaining requirements under federal labor laws.

#### *Securities Regulation*

##### The Securities Act of 1933

Since employees are deemed as much a part of the investing public as other people,<sup>135</sup> it is likely that most employers will be required to register their securities offered in connection with savings and invest-

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133. 48 STAT. 74, as amended, 15 U.S.C. § 77 (1952).

134. 48 STAT. 881, as amended, 15 U.S.C. § 78 (1952).

135. SEC v. Ralston Purina Co., 346 U.S. 119, 126 (1953).

ment plans under the Securities Act of 1933. As hereinafter pointed out,<sup>136</sup> however, the Securities and Exchange Commission has simplified the registration statements for securities offered to employees under plans of the type discussed that comply with specified requirements.

### *Exemptions From Registration*

It is believed the statutory exemptions of certain types of securities or transactions from the registration requirement would prove beneficial only to a few companies contemplating the adoption of a savings and investment plan. However, since they may prove useful to some employers, mention is made of three statutory exemptions prior to discussing the registration requirements for the employer's securities offered and sold under the plan.

Section 3(a)(11) of the Securities Act exempts from the necessity for registration:

"Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory."<sup>137</sup>

In construing this provision the General Counsel of the Commission has stated that:

"The so-called 'intrastate exemption' is not in any way dependent upon absence of use of the mails or instruments of transportation or communication in interstate commerce in the distribution. Section 3(a)(11) provides in effect that if the residence of the purchasers, the residence or place of incorporation of the issuer, and the place in which the issuer does business are all confined to a single state, the securities are exempt from the operation of Section 5 of the act."<sup>138</sup>

It is thus apparent that the above exemption would not be available to any company offering its stock under a savings and investment plan to employees who reside outside of the state in which it is physically located and in which it was incorporated.

The basis for another exemption is set forth in section 3(b) of the act, which provides as follows:

"The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be

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136. See text at notes 163-78 *infra*.

137. 48 STAT. 906 (1934), as amended, 15 U.S.C. § 77c(a)(11) (Supp. III, 1956).

138. SEC Securities Act Release No. 1459, 11 FED. REG. 10958 (1937).

prescribed therein, add any class of securities to the securities exempted as provided in this section, if it finds that the enforcement of this subchapter with respect to such securities is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering; but no issue of securities shall be exempted under this subsection where the aggregate amount at which such issue is offered to the public exceeds \$300,000."<sup>139</sup>

In implementation of section 3(b) the Commission has issued regulation A,<sup>140</sup> described by a leading text-writer as providing "not so much an exemption as a simplified form of registration for certain issues—by no means all issues—up to \$300,000."<sup>141</sup> Under that regulation the maximum amount of securities which may be offered by the issuer and all of its affiliates in the aggregate may not exceed \$300,000 in any one year.<sup>142</sup>

Regulation A prohibits the issuer from offering any securities until ten days (Saturdays, Sundays and holidays excluded) after the filing of a notification on a form prescribed by the Commission containing, in general, information about where the offer is to be made, a description of any additional securities sold or to be offered by the issuer and certain data about officers and directors of the issuer and its affiliates and predecessors.<sup>143</sup>

Written offers and sales of securities are also prohibited by regulation A unless an offering circular is concurrently given or has previously been given to the offeree.<sup>144</sup> The offering circular must include data about the issuer, its directors, the underwriter and the underwriting discounts or commissions.<sup>145</sup> It is also necessary for the circular to show statements of the issuer's financial condition as of ninety days prior to filing the above-mentioned notification, or as of such earlier periods up to six months as the Commission may permit upon written

139. 48 STAT. 75 (1933), as amended, 15 U.S.C. § 77c(b) (1952).

140. Regulation A was recently revised. SEC Securities Act Release No. 3663, 21 FED. REG. 5739-47 (1956) (hereinafter only Federal Register citation is given).

141. LOSS, SECURITIES REGULATION 166-67 (Supp. 1955).

142. Rule 254, 21 FED. REG. 5741 (1956). See Loss, *op. cit. supra* note 141, at 167.

"The aggregate offering price of securities which have a determinable market value shall be computed upon the basis of such market value as determined from transactions or quotations on a specified date within 15 days prior to the date of filing the letter notification, or the offering price to the public, whichever is higher; *provided*, that the aggregate gross proceeds actually received from the public shall not exceed the maximum aggregate offering price permitted. . . ." Rule 254(b), 21 FED. REG. 5741 (1956).

143. The notice is filed on form 1-A with the regional office of the Commission for the region in which the issuer's principal business operations are conducted. Rule 255, 21 FED. REG. 5741 (1956).

144. Rule 256(a)(1), 21 FED. REG. 5741 (1956).

145. Rule 256(a)(1), 21 FED. REG. 5744 (1956) (form 1-A, schedule I).

request, and presentation of data for two years previous to the date of those financial statements.<sup>146</sup> If the offering under an employee savings and investment plan is not completed within twelve months, the offering circular must be revised.<sup>147</sup> In addition, the Commission requires the periodic filing of a report of the sales of the securities described in the offering circular.<sup>148</sup>

Unless the employer is newly organized or did not have net income for at least one of the last two years, the securities may be offered or sold without the use of an offering circular provided the offering price does not exceed \$50,000. In such case, however, four copies of a statement setting forth specified information, including the name of the issuer, names of the directors and officers and their interest in the issuer, a description of the securities being offered, the name of the underwriter and the commission to be paid for the sale of the securities, must be filed as an exhibit to the form of notification filed with the Commission.<sup>149</sup>

It has been stated that the present administrative view is that regulation A is applicable to the securities used under employees' pension or profit-sharing plans so long as the contributions of employees do not exceed \$300,000 a year.<sup>150</sup> It is assumed the Commission would hold this view as to the applicability of regulation A to a savings and investment plan.

Section 4(1) of the Securities Act of 1933 exempts "transactions by an issuer not involving any public offering."<sup>151</sup> It is believed that this exemption could be successfully claimed only by those employers who limited the offer of their securities under plans of the type discussed to key executive personnel, a limitation not found in plans reviewed.<sup>152</sup> This conclusion is clearly supported by the decision of the Supreme Court in *SEC v. Ralston Purina Co.*,<sup>153</sup> in which the Court stated that the private-offering exemption did "not deprive corporate employees, as a class, of the safeguards of the Act."<sup>154</sup>

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146. Rule 256(a)(1), 21 FED. REG. 5745 (1956) (form 1-A, schedule I, item 11 (a)(1)).

147. Rule 256(e), 21 FED. REG. 5741 (1956). This rule applies to offerings under stock purchase, savings, stock options or other similar plans. In other types of offerings, this rule provides that unless the offering is completed within nine months from the date of the original offering circular a revised offering circular must be prepared, filed and supplied to offerees.

148. Rule 260, 21 FED. REG. 5742 (1956). This report must be filed with the appropriate regional office within thirty days after the end of each six-month period following the date of the original offering circular.

149. Rule 257, 21 FED. REG. 5742 (1956).

150. LOSS, *op. cit. supra* note 141, at 169.

151. 48 STAT. 77, as amended, 15 U.S.C. § 77d(1) (Supp. III, 1956).

152. See text at notes 8-12 *supra*.

153. 346 U.S. 119 (1953).

154. *Id.* at 125.

In that case Ralston Purina sold nearly \$2,000,000 of stock to employees without registration and by use of the mails.<sup>155</sup> Among those who purchased stock were employees with the duties of artist, bakeshop foreman, chow loading foreman, clerical assistant, copywriter, electrician, stock clerk, mill office clerk, order credit trainee, production trainee, stenographer and veterinarian. The record showed that 414 employees bought stock in 1949 and 411 in 1950. The offer was not made to all of Ralston Purina's employees; only to those whom it was felt would "take the initiative and are interested in buying stock at present market prices."<sup>156</sup> It was estimated that in 1951 the offer was made to 500 of the company's 7,000 employees.<sup>157</sup>

Reversing the court of appeals,<sup>158</sup> the Supreme Court in construing the private-offering exemption held that the employees involved should not have been deprived of the safeguards of the act because they were not shown to have access to the kind of information which registration would disclose.<sup>159</sup> The Court recognized that some employee offerings may come within the private-offering exemption, such as one made to executive personnel who in their duties have access to the kind of information the act would make available to them in the registration statement.<sup>160</sup> In view of that decision, the private-offering exemption would not be available to employers offering a savings and investment plan to employees generally or to classes of employees, such as all salaried or wage employees.<sup>161</sup>

In addition to the above statutory exemptions, the Division of Corporation Finance of the Securities and Exchange Commission has not required registration of securities of the employer in those plans where the employees' contribution may be invested only in United States Government Bonds, Series E,<sup>162</sup> even though the employer's

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155. *Id.* at 121.

156. *Ibid.*

157. *Ibid.*

158. SEC v. Ralston Purina Co., 200 F.2d 85 (8th Cir. 1952).

159. 346 U.S. at 127.

160. *Id.* at 125-26.

161. The Commission in SEC Securities Act Release No. 285, Jan. 24, 1935, stated the factors to be considered in determining whether there is a public offering are (1) number of offerees and their relationship to issuer, (2) number of units offered, (3) size of offerings, (4) manner of offerings and (5) intent of offerees. The private-offering exemption may be available for stock sold under stock option plans limited to key employees. See Dean, *Employee Stock Options*, 66 HARV. L. REV. 1403, 1442-43 (1953).

162. See THE DU PONT THRIFT PLAN. The United States Government bonds, of course, are exempt under § 3(a)(2) of the Securities Act, 48 STAT. 75 (1933), as amended, 15 U.S.C. § 77c(a)(2) (1952).

The Commission is reported as saying that no question would be raised "with respect to the registration of participations in a voluntary contributory pension, profit sharing, or similar plan that does not invest in the securities of the employer company in an amount exceeding the company's contributions. In the event that the

payment to the plan is invested in the employer's securities. Apparently the Commission and the staff feel there is no need to provide the employee-investor with the statutory safeguards in that type of plan since the employee's investment in United States Savings Bonds assures him of getting back at least as much as he contributed.

### *Registration Requirements*

Registration of the securities offered under a savings and investment plan might not be as burdensome as it might at first appear. In 1953 the Commission adopted form S-8 as a "simplified form" of registration for securities offered under plans of the type under discussion.<sup>163</sup> This form can be used by an issuer who files reports pursuant to section 13<sup>164</sup> or 15(d)<sup>165</sup> of the Securities Exchange Act of 1934. Form S-8 was adopted, the Commission stated, in recognition of the fact that in most such plans the investment decision required by the employee "is of a substantially different character than is involved where securities offered for the purpose of raising capital are sold upon the best obtainable terms."<sup>166</sup> The Commission also said that form S-8 is not intended for the registration of securities offered primarily for the purpose of raising capital.<sup>167</sup>

In order to use the form S-8 the plan should have the following requisites:

"(a) Periodic cash payments are made, or periodic payment payroll deductions are authorized, by participating employees in an amount not to exceed a specified percentage of the employee's compensation or a special maximum annual amount;

"(b) Contributions are made by the employer at least annually in cash or equity securities of the issuer in accordance with a specified formula or arrangement;

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plan does invest in securities of the employer company in excess of such amount, a registration statement or statements should be filed (in the absence of an appropriate exemption), both with respect to the plan participations and the company's securities, regardless of whether such shares are purchased directly from the company or on the open market." P-H SEC. REG. SERV. para. 1945.2 (1953). See LOSS, SECURITIES REGULATION 152 (Supp. 1955).

163. SEC Securities Act Release No. 3480, 18 FED. REG. 3688 (1953). The fee for filing is one-hundredth of 1% of maximum aggregate price at which such securities are proposed to be offered, but in no case shall the fee be less than \$25. 48 STAT. 78 (1933), 15 U.S.C. § 77f(b) (1952).

164. 48 STAT. 894 (1934), 15 U.S.C. § 78m (1952). Section 13 requires every issuer of securities registered on a national securities exchange to file information, documents and reports with the exchanges and the Commission as they may require.

165. Under § 15(d), 48 STAT. 895 (1934), as amended, 15 U.S.C. § 78o(d) (1952), each registration statement filed pursuant to the Securities Act of 1933 must contain an undertaking by the issuer to file reports or other documents required by the Commission.

166. SEC Securities Act Release No. 3480, 18 FED. REG. 3688 (1953).

167. *Ibid.*



“(c) Equity securities of the issuer purchased with funds of the plan are acquired in amounts which, at the time of the payment of the purchase price, do not exceed the funds deposited or otherwise available for such payment; provided, that such purchases are made periodically, or from time to time upon a reasonably current basis, and at prices not in excess of the current market price at the time of purchase;

“(d) Prior to the time the employee becomes entitled to withdraw all funds or securities allocable to his account, he may withdraw at least that portion of the cash and securities in his account representing his contributions.”<sup>168</sup>

The following conditions also must be met:

“(a) A copy of the issuer’s annual report to stockholders for the last fiscal year is delivered with the prospectus to each eligible employee. If the last fiscal year of the issuer has ended within 90 days prior to the use of the prospectus, the annual report for the preceding fiscal year may be delivered, provided the annual report for the last fiscal year is furnished to each such employee when available.

“(b) The employer undertakes in the registration statement to transmit to all employees participating in the plan copies of all reports, proxy statements and other communications distributed by the issuer to its stockholders generally.”<sup>169</sup>

The registration statement on form S-8 includes the facing sheet of the form, the prospectus, signatures, undertakings and exhibits.<sup>170</sup> Generally, the prospectus must set forth the following: (a) information about the plan, such as its purpose and title; (b) who may participate; (c) amount of contributions of the employee and employer; (d) terms and conditions of withdrawal, and whether the employee may assign his interest; (e) how defaults may arise under the plan and the consequences thereof; (f) information about the administration of the plan; (g) how funds are invested and, if securities are to be purchased otherwise than in the open market, from whom to be purchased; (h) whether any one has or may create a lien on any funds or property held under the plan; (i) circumstances under which plan will terminate; (j) charges and deductions other than taxes that may be made against the employee; (k) summary of earnings for the past five years; (l) range of market price of issuer’s securities being regis-

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168. SEC Form S-8, general instructions AI. See SEC Securities Act Release No. 3480, 17 C.F.R. § 239.16 b (Supp. 1956).

169. SEC Form S-8, general instructions AII.

170. *Id.* general instructions C.

tered for each year in which earnings data is supplied; (m) significant developments during past five years, such as bankruptcy, receivership, reorganization and acquisition or disposition of assets; (n) class of capital stock being registered and rights with respect thereto, and any restrictions on the repurchase or redemption of shares by issuer while there is an arrearage in payment of dividends or sinking fund installments; (o) other securities being registered; and (p) the principal holders of equity securities of the issuer.<sup>171</sup>

The prospectus must also contain certain financial statements, including a balance sheet and a profit and loss statement.<sup>172</sup> If the annual report of the issuer for its last fiscal year includes certified financial statements substantially meeting the above requirements, the financial statements may be incorporated by reference in the prospectus.<sup>173</sup>

Exhibits filed as part of the registration statement (which do not form a part of the prospectus)<sup>174</sup> must include copies of the plan and material contracts not made in the ordinary course of business currently in effect or made during the past two years relating to the plan. In addition, the employer is required to submit opinion of counsel as to the legality of the interests and the equity securities being registered, indicating whether, when sold, they will be legally issued, fully paid and nonassessable, and a copy of the annual report to stockholders for the previous year, and copies of communications about the plan intended to be used in connection with the offering or sale of the securities being registered.<sup>175</sup>

In signing the registration statement the employer undertakes to supply all participating employees copies of all information distributed to stockholders generally, including proxy statements.<sup>176</sup>

Under a rule<sup>177</sup> of the Commission, copies of a preliminary prospectus filed with the form S-8 registration statement may be circularized to the employees eligible to enroll in the plan prior to the effective date of the registration statement. This prospectus must show substantially all the information above outlined except the offering price, underwriting discounts and other related matter, and must bear in red ink the caption "Preliminary Prospectus" and the "red herring" legend that, among other things, the information contained in the prospectus is subject to completion and amendment and that

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171. *Id.* items 1-16.

172. *Id.* item 17.

173. *Ibid.*

174. *Id.* instructions as to exhibits.

175. *Ibid.*

176. *Id.* undertakings B.

177. Rule 433, 17 C.F.R. § 230.433 (Supp. 1956).

securities may not be sold prior to the time the registration statement becomes effective.

Information in the prospectus, required to be given to each eligible employee, must be kept up to date. When a prospectus is used more than nine months after the effective date of a registration statement, the data set forth in the prospectus must be of a date within sixteen months of such use.<sup>178</sup>

#### Securities Exchange Act of 1934

One of the goals of the Securities Exchange Act of 1934<sup>179</sup> is public disclosure of information materially important to investors with respect to securities traded on public exchanges.<sup>180</sup> Consistent with this objective, the Commission's proxy regulation requires companies subject to the regulation to disclose in proxy-soliciting material a statement of direct remuneration for services in all capacities paid by the issuer and its subsidiaries during the issuer's last fiscal year to each director and to each of the three highest paid officers whose direct aggregate remuneration exceeded \$30,000, and also the aggregate amount paid to all directors and officers as a group.<sup>181</sup> The proxy statement must also show the amount to be paid to the above persons under any existing plan or arrangement.<sup>182</sup> Should the plan be submitted to the stockholders for approval, the proxy material must set forth, among other things, the material features of the plan and all bonus, profit-sharing or other remuneration plans, the class of persons who will participate, and the amounts which would have been distributable to directors, officers and employees if the plan had been in effect.<sup>183</sup>

It is noted that some companies have shown in a separate column in the remuneration tabulation in the proxy statement the employer contributions for the benefit of officers and directors under the savings and investment plan,<sup>184</sup> while other companies have set forth the specific payments under the plan for directors and officers as a note to the remuneration table.<sup>185</sup>

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178. 68 STAT. 686 (1954), 15 U.S.C. § 77j(a)(3) (Supp. III, 1956); see 17 C.F.R. § 230.427 (Supp. 1956). The prospectus furnished to the participants in the plan who previously received a prospectus need contain only the information specified in rule 430, 17 C.F.R. § 230.430 (1949).

179. 48 STAT. 881, as amended, 15 U.S.C. § 78 (1952).

180. H.R. REP. No. 1383, 73d Cong., 2d Sess. 11 (1934).

181. 17 C.F.R. § 240.14a (Supp. 1956) (schedule 14A, item 7(a)).

182. *Ibid* (schedule 14A, item 7(c)).

183. *Ibid* (schedule 14A, item 9).

184. See STANDARD OIL COMPANY (IND.), 1956 PROXY STATEMENT; STANDARD OIL COMPANY (N.J.), 1956 PROXY STATEMENT.

185. See SEARS, ROEBUCK & Co., 1955 PROXY STATEMENT; SINCLAIR OIL CORPORATION, 1955 PROXY STATEMENT.

Information concerning remuneration to directors and officers need not be disclosed in the annual report to the Commission (Form 10-K) for the year in which the plan is adopted if, since the close of the fiscal year, the employer has filed with the Commission pursuant to the proxy regulation a definitive proxy statement which concerned the election of directors.<sup>186</sup>

In addition, pursuant to section 16(a)<sup>187</sup> of the Securities and Exchange Act, officers<sup>188</sup> and directors would have to report to the Commission the acquisition under the plan of securities of their employer.<sup>189</sup> There might be question as to when this form should be filed if the plan provides that the shares will be held by a trustee (or some other person) prior to delivery to the director or officer. Since section 16(a) requires the reporting of shares when the reporting person becomes the "beneficial owner,"<sup>190</sup> it would appear that the form should be filed at the time the officer or director becomes entitled to receive the dividends and vote the shares should he acquire such rights prior to the time the shares are delivered to him.<sup>191</sup>

In a recent amendment to rule X-16B-3<sup>192</sup> the Commission exempted from the profit-recovery provisions of section 16(b)<sup>193</sup> of the Securities Exchange Act the acquisition of securities under, among others,<sup>194</sup> savings and investment plans which meet certain conditions. To qualify for this exemption the plan must be approved, or a charter amendment authorizing stock for issuance pursuant to the plan must be approved, by the holders of at least a majority of the securities of

186. See 17 C.F.R. § 249.310 (Supp. 1956) (form 10-K, general instructions ¶ D).

187. 48 STAT. 896 (1934), 15 U.S.C. § 78p(a) (1952).

188. In rule X-3B-2, 17 C.F.R. § 240.3b-2 (1949), the Commission has defined the term "officer" to mean "a president, vice president, treasurer, secretary, comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers." For cases concerning definition of officer, see *Colby v. Klune*, 178 F.2d 872 (2d Cir. 1949); *Lockheed Aircraft Corp. v. Campbell*, 110 F. Supp. 282 (S.D. Cal. 1953); *Lockheed Aircraft Corp. v. Rathman*, 106 F. Supp. 810 (S.D. Cal. 1952).

189. This information is filed on form 4, which must be filed within ten days after the close of the month in which there occurs any change in direct or indirect beneficial ownership. 17 C.F.R. § 249.104 (1949).

190. 48 STAT. 896 (1934), 15 U.S.C. 78p(a) (1952).

191. See rule X-16A-8, 17 C.F.R. § 240.16a-8 (Supp. 1956).

192. SEC Securities Exchange Act Release No. 5312, 21 FED. REG. 3646 (1956).

193. 48 STAT. 896 (1934), 15 U.S.C. § 78p(b) (1952).

194. The amended rule X-16B-3 exempts stock or options acquired pursuant to bonus, profit-sharing, retirement, stock option, thrift, savings or similar plans. 21 FED. REG. 3647 (1956). See *Greene v. Dietz*, CCH FED. SEC. L. REP. ¶ 90768 (S.D. N.Y. July 16, 1956), in which court held that the acquisition of stock pursuant to a restricted stock option plan came within the purview of rule X-16B-3 as it existed in 1952.

the issuer at a meeting for which proxies were solicited substantially in accordance with the Commission's proxy regulation. The stockholders may give their approval by written consent provided they are solicited as described. In addition, the aggregate amount of funds or securities which may be allocated pursuant to the plan must be limited by stating either the maximum amount which may be allocated to each participant in the plan or the maximum amount which may be allocated to all participants. These limitations may be fixed for each fiscal year or for the duration of the plan, or they may be determined by fixed amount of securities or funds or by formulas based upon earnings of the issuer, dividends paid, compensation received by participants or similar factors which will result in a determinable limitation.<sup>195</sup>

### Investment Company Act of 1940

As its title suggests, the Investment Company Act of 1940<sup>196</sup> is concerned with the regulation of investment companies.<sup>197</sup> Most plans of the type under discussion would not have any problems under this act because section 3(c)(13) excludes from the definition of an investment company "any employees' stock bonus, pension, or profit-sharing trust which meets the conditions of section 165 [now section 401]<sup>198</sup> of the Internal Revenue Code."<sup>199</sup>

If the plan does not qualify for exemption under that provision, the applicability of the act is determined by reference to the section which defines an employees' securities company as:

"[A]ny investment company or similar issuer all of the outstanding securities of which (other than short-term paper) are beneficially owned (A) by the employees or persons on retainer of a single employer or of two or more employers each of

195. SEC Securities Exchange Act Release No. 5312, 21 FED. REG. 3647 (1956). It might be of interest to note that in 1955 the Commission amended rule X-10B-6 to provide that it shall not be an unlawful manipulative practice for an issuer to purchase securities for a plan of the type under discussion during a public distribution of securities of the same class or series being used for the plan. 17 C.F.R. § 240.10b-6(e) (Supp. 1956).

196. 54 STAT. 789, as amended, 15 U.S.C. § 80a (1952).

197. An investment company is defined as "any issuer which—(1) is . . . engaged primarily . . . in the business of investing, reinvesting, or trading in securities, (2) is engaged . . . in the business of issuing face-amount certificates of the installment type . . . or (3) is engaged . . . in the business of . . . owning securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets. . . ." 54 STAT. 797 (1940), 15 U.S.C. § 80a-3 (a) (1952).

198. See text at notes 91-105 *supra*, for discussion of § 401 of the Internal Revenue Code.

199. 54 STAT. 797 (1940), as amended, 15 U.S.C. § 80a-3(c)(13) (1952).

which is an affiliated company of the other, (B) by former employees of such employer or employers, (C) by members of the immediate family of such employees, persons on retainer, or former employees, (D) by any two or more of the foregoing classes of persons, or (E) by such employer or employers together with any one or more of the foregoing classes of persons.”<sup>200</sup>

Under section 6(b) of the act the Commission may grant exemption if, and to the extent that, the exemption is consistent with the protection of investors.<sup>201</sup> One exemption issued by the Commission under that section, of particular interest here, involved the plan of Tennessee Gas and Transmission Company.<sup>202</sup> Under Tennessee's plan the employee contributed two to eight per cent of his pay to a trust administered by a national bank and by an administration committee of five persons appointed by the company. The company equaled the participant's contribution. The employee could direct that his proportionate share of the fund be invested in securities of the Tennessee Company, government bonds, other securities selected by the administration committee or in a special fund managed by the trustee and invested in securities legal for trust investments. Only in the special fund were the securities of the several employee-participants pooled.

The Commission found that the special fund was the only portion of Tennessee's plan which came within the purview of the Investment Company Act. The Commission said that the other plans of investment involve, in essence, individual trust accounts held by the trustee for the individual and sole benefit of each employee-participant. It found that since the other plans of investment involved only single trust accounts, they did not come within the meaning of "investment company" as that term is defined in the act. However, the Commission ruled that the special fund presented a different problem because the amounts allocated to that fund were pooled by the trustee for the purchase of investments legal under the Texas trust law.

The Commission exempted the employee's trust from all provisions of the Investment Company Act, except certain reporting requirements and the prohibition against borrowing of funds from the trust by affiliated persons of the employer, because (a) the plan was organized as a trust, (b) Tennessee guaranteed that each employee would on liquidation receive an amount at least equal to his contribution, (c)

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200. 54 STAT. 790 (1940), 15 U.S.C. § 80a-2(a) (13) (1952).

201. 54 STAT. 800 (1940), 15 U.S.C. § 80a-6(b) (1952).

202. Thrift Plan of Tennessee Gas and Transmission Company, 24 S.E.C. 241 (1946).

all expenses were paid by Tennessee and (d) investments were confined to "legals."<sup>203</sup>

A regulation<sup>204</sup> issued by the Commission pursuant to section 17(d)<sup>205</sup> of the Investment Company Act prohibits any employee of an investment company from participating in any bonus, profit-sharing or pension plan in which any registered or "controlled" company<sup>206</sup> is a participant, unless an application regarding the plan has been filed with the Commission and the application has been granted. The application should be granted prior to submission of the plan to security holders or, if not so submitted, prior to the adoption thereof.<sup>207</sup> Applications for plans of controlled companies which are not investment companies need not be filed with the Commission if no employees, officers or directors of a registered investment company are eligible to participate in the plan.<sup>208</sup>

It might be questioned whether a savings and investment plan is the sort of activity between investment companies or controlled companies and employees of such companies which Congress intended should be regulated by the Commission pursuant to section 17(d) of the act.<sup>209</sup> Nevertheless, at least one company which the Commission deems subject to regulation N-17D-1 filed an application<sup>210</sup> for its plan under that regulation and the Commission issued an order granting the application.<sup>211</sup>

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203. *Id.* at 244.

204. Regulation N-17D-1, 17 C.F.R. § 270.17d-1 (Supp. 1956). The Commission has under consideration a proposal to amend rule N-17D-1. SEC Investment Company Act of 1940 Release No. 2226, 20 FED. REG. 7112 (1955).

205. 54 STAT. 816 (1940), 15 U.S.C. § 80a-17(d) (1952).

206. Under § 2(a) (9) of the Investment Company Act there is a presumption of control if any person or company owns beneficially, either directly or through controlled companies, more than 25% of the voting securities of a company, 54 STAT. 790 (1940), 15 U.S.C. § 80a-2(a) (9) (1952).

207. 17 C.F.R. § 270.17d-1(a) (Supp. 1956).

208. 17 *id.* § 270.17d-1(c) (1) (Supp. 1956). The act defines an employee, officer or director as an "affiliated person of another person." 54 STAT. 790 (1940), 15 U.S.C. § 80a-2(a) (3) (D) (1952).

209. Section 17 of the act states that it shall be unlawful for any affiliated person of or principal underwriter for a registered investment company, or any affiliated person of such a person or principal underwriter, acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a joint participant, in contravention of such rules and regulations as the Commission may prescribe for the purpose of limiting or preventing participation by such registered company or controlled company on a basis different from or less advantageous than that of another participant. 54 STAT. 815 (1940), 15 U.S.C. § 80a-17(d) (1952).

210. In the Matter of E. I. du Pont de Nemours and Company, 20 FED. REG. 3923 (1955).

211. *Id.* at 5439.

## State Blue Sky Laws

Counsel for companies considering the adoption of a savings and investment plan, especially in the case of companies whose employees are located in more than one state, should also consider the applicability of the blue sky laws of each state in which a prospective employee-participant in the plan lives or works. All states except Delaware and Nevada have some type of blue sky law.<sup>212</sup>

One text writer divides these laws into three general types: (a) the anti-fraud variety, which does not require registration either of securities or of brokers and dealers; (b) those which require broker-dealer registration; and (c) those which require registration of the securities.<sup>213</sup> It is pointed out, however, that these general types exist in various combinations and there are a number of modifications of each type.<sup>214</sup> Of the forty-six state blue sky laws, forty require registration of securities.<sup>215</sup>

The blue sky laws of at least one state exempt securities issued in connection with employee stock-purchase or similar benefit plans.<sup>216</sup> One blue sky law does not apply to interests in a profit-sharing plan or to trusts which qualify under the federal income tax law.<sup>217</sup> In another state, exemption from registration for securities issued under a savings and investment plan has been granted by administrative ruling.<sup>218</sup>

A number of state laws have exemption provisions which it is believed would apply to a substantial segment of the companies that may be considering adopting a plan of the type under discussion. Most of the states whose laws require registration exempt securities

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212. LOSS, SECURITIES REGULATION 7, 407-08 (Supp. 1955).

213. LOSS, SECURITIES REGULATION 20 (1951).

214. *Ibid.*

215. *Id.* at 30.

216. VA. CODE ANN. § 13.1-514(11) (Supp. 1956).

217. MISS. CODE ANN. § 5380(n) (Supp. 1954). The Illinois law exempts securities issued pursuant to employee security purchase plans if securities would be exempt pursuant to any other provision. ILL. ANN. STAT. c. 121-3/2, § 137.3N (Smith-Hurd Supp. 1955). An unqualified exemption is given to securities issued pursuant to employee profit-sharing trusts or plans. *Id.* § 137.3o.

218. In Colorado the attorney general has ruled that a contributory thrift plan, under which the participants direct the investment of their contribution in either government bonds, company stock or both, and in which their interests were not assignable, is exempt from the Colorado blue sky law. Reported in CCH PENSION PLAN GUIDE ¶1401 (1953). However, the Pennsylvania Securities Commission has ruled that a corporation in offering its securities to its employees residing in Pennsylvania is not exempt from registration under the Pennsylvania blue sky law. Such corporation must register as a dealer and also register at least one salesman before making such offering. The application for a salesman may be filed in the name of an officer of the corporation. Pennsylvania Securities Commission, Bi-Monthly Bulletin, June 1, 1956, reported in 2 CCH BLUE SKY L. REP. para. 41,601.02 (1956).



listed on the stock exchange.<sup>219</sup> In addition, several state statutes exempt securities listed in one of the standard manuals.<sup>220</sup>

Under many of these laws registration may be by notification or qualification. Registration by notification is limited generally to securities issued by a corporation that has been in continuous operation with a favorable earning record for a prescribed number of years.<sup>221</sup> Such registration usually requires the filing of a statement containing the name and address of the issuer, a brief description of the security, amount of the issue and the amount to be offered in the state, offering price and a copy of the circular to be used for public offering.<sup>222</sup>

Those securities which do not qualify for registration by notification or which are not otherwise exempt must be registered by qualification. Registration by this method requires the filing of a great deal more information than does registration by notification.<sup>223</sup>

#### *United States Treasury Regulations With Respect to Government Bonds*

If one of the investment media to be provided by the plan is United States Government bonds, in drafting the plan particular attention should be given to United States Treasury regulations governing the issue, registration, payment and reissue of bonds. Under these regulations bonds may be registered only in the name of

219. *E.g.*, the Florida statute, FLA. STAT. ANN. § 517.05(6) (Supp. 1955), exempts securities appearing in any list of securities dealt in on the stock exchange of any city of the United States of more than one million inhabitants; the Illinois statute, ILL. ANN. STAT. c. 121-½, § 137.3G (Smith-Hurd Supp. 1955), exempts securities listed on the New York, American, Boston or Midwest stock exchanges, or the Board of Trade of the City of Chicago; the Michigan statute, MICH. COMP. LAWS § 451.104(j) (1948), exempts securities listed on the New York Stock Exchange. Some of the statutes authorize the administrative officer to designate the stock exchanges. *E.g.*, ALA. CODE ANN. tit. 53, § 4(f) (1940), exempts securities listed on the New York Stock Exchange and other exchanges approved by the Commissioner; the Kansas statute, KAN. GEN. STAT. ANN. § 17-1224(4) (1949), exempts securities listed on exchanges approved by the Corporation Commission. In LOSS, SECURITIES REGULATION 14 (Supp. 1955), it is stated that thirty-six states either by statute or regulation exempt all securities listed on specified stock exchanges. For a list of state laws exempting securities listed on stock exchanges, see 1 CCH BLUE SKY L. REP. 851-70 (1955).

220. See LOSS, SECURITIES REGULATION 44 (1951) and substitute n.115 in *id.* at 14 (Supp. 1955). For a list of state laws exempting securities listed in standard manuals, see 1 CCH BLUE SKY L. REP. 801-02 (1956).

In connection with stock option plans it has been suggested that if the prospective optionees reside in a number of states, the risk of violating the state blue sky laws would be reduced if the out-of-state optionees accepted delivery of the option at the home office of the employer corporation and the option were drafted so that sale of stock subject to the option is made at the employer corporation's home office. Dean, *Employee Stock Options*, 66 HARV. L. REV. 1403, 1448 (1953).

221. See, *e.g.*, KAN. GEN. STAT. ANN. § 17-1227 (1949).

222. See 1 CCH BLUE SKY L. REP. para. 510 (1953).

223. See, *e.g.*, KAN. GEN. STAT. ANN. § 17-1228 (1949); 1 CCH BLUE SKY L. REP. para. 511 (1953).

one person, in the names of two persons as co-owners, or in the name of one person payable on death to another.<sup>224</sup> These regulations also state how bonds shall be paid or reissued upon the death of a registered owner.<sup>225</sup>

One regulation provides that bonds of Series E may be registered in the name of a trustee or trustees of an employee savings plan.<sup>226</sup> In order to qualify under this regulation, approval must be obtained from the federal reserve bank of the applicable district.<sup>227</sup>

Those companies having employees in foreign countries should also consider the part of the regulations which provides that only (1) residents of the United States, (2) citizens of the United States temporarily residing abroad, and (3) nonresident aliens employed in the United States by the federal government or any agency thereof are eligible to purchase savings bonds.<sup>228</sup> In the event savings bonds were the only security under the plan for the investment of employee savings, that regulation would appear to prohibit the participation of aliens employed in foreign countries, or if under the plan there were investment alternatives, that regulation would eliminate government bonds from the investment choice of such employees. It has recently come to the authors' attention that the United States Treasury will permit the registration of bonds of nonresident alien employees who are actually employed in the United States.<sup>229</sup> This means, for example, that a citizen and resident of Canada employed in a plant in the United States could have United States Government bonds registered in his name.

### *Government Contracts*

Employers who have cost-plus-fixed-fee contracts with the United States Government must also consider whether their contribution to the fund for employees working under such contracts is a reimbursable cost. It may be apparent from the contract provisions that the employer's payments under savings and investment plans would be allowable costs. If such costs are not provided for, the factors which determine the allowability of costs include (1) reasonableness, (2)

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224. 31 C.F.R. § 316.6 (Supp. 1956).

225. 31 *id.* § 315.47. It has been held that federal law is applicable to determine rights of private holders and transferees of United States Government bonds. *Bank of America Nat'l Trust and Sav. Ass'n v. Rocco*, 226 F.2d 297 (3d Cir. 1955). See *Recent Developments*, 56 COLUM. L. REV. 438 (1956).

226. 31 C.F.R. § 316.6a (Supp. 1956).

227. 31 *id.* § 316.6a(b)(1).

228. 31 *id.* § 315.3.

229. Letter from Fiscal Assistant Secretary of United States Treasury Department to Vice President of Federal Reserve Bank of Philadelphia, May 25, 1956.

application of accepted accounting principles and practices and (3) any specific limitations on costs included in the contract terms.<sup>230</sup> Bonuses, pensions and compensation benefits are generally accepted as allowable costs.<sup>231</sup>

In fixed-price contracts the question of allocation of the employer's contributions usually will not be raised by the Government since the cost problem is primarily the responsibility of the contractor. If the contract has a price redetermination clause, however, the employer's cost of the plan could become an issue.<sup>232</sup>

Under the Renegotiation Act of 1951, as amended,<sup>233</sup> payments made by an employer on account of a stock bonus or profit-sharing plan will be allowed as an item of cost against renegotiable business to the extent allocable to such business, where the payments have been determined by the Internal Revenue Service to be deductible for federal income tax purposes.<sup>234</sup>

## *Laws Regulating Labor*

### Wage-Hour Laws

There are two important federal statutes regulating the wages and hours of workers. The more comprehensive one, the Fair Labor Standards Act,<sup>235</sup> establishes minimum wages for all workers engaged in interstate activities and requires the payment of overtime. The other, the Walsh-Healey Public Contracts Act,<sup>236</sup> provides for the

230. 32 C.F.R. § 15.201 (rev. ed. 1954).

231. 32 *id.* § 15.204(c) (p).

232. See LUPTON, *GOVERNMENT CONTRACTS SIMPLIFIED* 367-68 (1953).

233. 65 STAT. 7, as amended, 50 U.S.C. APP. §§ 1212(a)(d), 1215(d)(f)(3), 1216(a)(4), (6)-(9), (c) (Supp. III, 1956).

234. 32 C.F.R. § 1459.2(d) (rev. ed. 1954).

235. 52 STAT. 1060 (1938), 29 U.S.C. §§ 201-19 (1952). This law applies to industries in interstate commerce. Persons who willfully violate the act are subject to a fine of not more than \$10,000 or to imprisonment for not more than six months, or both. In addition, any person who violates the minimum wage or maximum hours provision of the law is liable to the employees in the amount of their unpaid wages or overtime wages and in an additional equal amount as liquidated damages. 52 STAT. 1069 (1938), 29 U.S.C. § 216 (1952).

236. 49 STAT. 2036 (1936), 41 U.S.C. §§ 35-45 (1952). Under the act a contract made by an agency of the United States for the manufacture or furnishing of materials, supplies, articles and equipment in any amount exceeding \$10,000 must include certain stipulations and representations, among which is the agreement of the contractor that he will pay minimum wages as established by the Secretary of Labor and that the employees will not be permitted to work in excess of eight hours per day. 49 STAT. 2036 (1936), 41 U.S.C. §§ 35(b),(c) (1952). The act generally requires contractors to agree to minimum wages set by the Secretary of Labor for specific industries, overtime pay, and other labor requirements. Both the Fair Labor Standards Act and the Walsh-Healey Act may apply at the same time. *Powell v. United States Cartridge Co.*, 339 U.S. 497, 515-20 (1950).

Violation of the act renders the party responsible for the breach to liquidated damages, including a sum equal to the amount of any deductions, rebates or refunds,

establishment of minimum and overtime wages for persons engaged in the manufacture or furnishing to the federal government of material, supplies, articles or equipment in any amount exceeding \$10,000.

Since both acts provide for minimum wages and overtime pay, they raise the questions of (a) whether deduction from pay—if this is the method provided in the plan for employee savings—will be considered part of wages for the purpose of determining compliance with the required minimum pay,<sup>237</sup> and (b) whether the employer's contribution is includable in the computation of overtime.

A bulletin of the Wage and Hour Administrator of the Department of Labor issued under the Fair Labor Standards Act, and also applied to the Walsh-Healey Public Contracts Act, states that deductions from earnings of employees may be treated as payments of compensation provided the employer does not directly or indirectly profit from the transaction.<sup>238</sup> If the employer does so profit, the deduction would not be considered equivalent, for the purpose of the act, to payment to the employee. The type of savings and investment plan which provides for deduction from the employee's pay to purchase an employer's stock at approximate market value or less or to purchase United States Government bonds or other securities obviously would not involve prohibited employer profiting. Employers have been permitted to treat deductions as payments to employees where they were used to purchase, on the employees' behalf, United States Savings Stamps or United States Savings Bonds.<sup>239</sup> Any uncertainty on this question may, of course, be clarified by application to the Administrator of the Wage and Hour and Public Contracts Divisions for a ruling.

The employer's contribution is not includable in the overtime computation if the savings and investment plan meets the regulations of the Wage and Hour and Public Contracts Divisions of the Department of Labor.<sup>240</sup> These regulations require, among other things, that the plan be in writing and set forth specifically the categories of eligibility, that the amount the employee may save be specified, and

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or underpayment of wages due any employee working under a contract subject to the act. In addition, the agency of the United States which entered into the contract has the right to cancel the contract and to make open-market purchases or enter into other contracts for the completion of the original contract, charging any additional cost to the contractor who breached the law. 49 STAT. 2037 (1936), 41 U.S.C. § 36 (1952).

237. Employees subject to the Fair Labor Standards Act must be paid a minimum wage of \$1 an hour. 52 STAT. 1062 (1938), as amended, 29 U.S.C. § 206 (Supp. III, 1956). The law also provides for the payment of an overtime wage of time and one-half for hours worked in excess of forty hours weekly. 52 STAT. 1063 (1938), as amended, 29 U.S.C. § 207 (1952).

238. 29 C.F.R. § 777.15(a) (1949).

239. 29 *id.* § 777.15(c).

240. 29 C.F.R. §§ 547.0-.3 (Supp. 1956).

that the employer's total contribution not exceed fifteen per cent of the participating employees' total annual earnings.<sup>241</sup> In addition, employee's wages or salary cannot depend upon or be influenced by the existence of the savings and investment plan, and the amount paid by the employer may not be based upon the employee's hours of work, production or efficiency.<sup>242</sup>

#### Kickback Legislation .

Special permission may be required to make payroll deductions for employees subject to the Davis-Bacon Act<sup>243</sup> or the Copeland "Kickback" Act.<sup>244</sup> The Davis-Bacon Act prohibits paying to mechanics and laborers engaged on federal public works contracts of a value exceeding \$2,000 an amount less than the minimum wages prevailing in a particular locality for corresponding work as determined by the Secretary of Labor. The employer-contractor must agree in writing to pay the specified wages without rebate or deduction. Although the Copeland Act does not provide for the establishment of minimum wages, it does prohibit any rebates or deductions from pay. The Copeland Act has a broader coverage than the Davis-Bacon Act, protecting the wages of "any person" employed in the construction or completion of a public building or public work regardless of the amount involved.<sup>245</sup>

Under the regulations applicable to these acts, payroll deductions may be made for the payment of the purchase price of United States Defense Stamps and Bonds and United States Tax Savings Notes.<sup>246</sup> If deductions from the pay of employees within the purview of these acts are invested in securities other than government obligations,

241. 29 *id.* § 547.1.

242. 29 *id.* § 547.2.

243. 46 STAT. 1494 (1931), as amended, 40 U.S.C. § 276a (1952). Every contract subject to this act must contain the stipulations that without rebate at least once a week the contractor shall pay full amounts at wage rates not less than those in advertised specifications, that the scale of wages to be paid shall be posted at the site of the work, and that there may be withheld from the contractor so much of accrued payments necessary to pay to laborers and mechanics the difference between the wages required by the contract and the wages paid. 46 STAT. 1494 (1931), as amended, 40 U.S.C. § 276a (1952). The contract must also stipulate that in the event the contractor is paying less than required wages, the contracting officer may terminate his right to proceed with the contract and the contractor shall be liable to the government for any excess cost of the government in completing the contract. 49 STAT. 1011 (1935), 40 U.S.C. § 276a-1 (1952). The eight-hour laws, 27 STAT. 340 (1892), as amended, 40 U.S.C. §§ 321-22 (1952); 37 STAT. 137 (1912), 40 U.S.C. §§ 324-25 (1952); 54 STAT. 884 (1940), 40 U.S.C. § 325a (1952), supplement the Davis-Bacon Act by providing for overtime payments.

244. 62 STAT. 740 (1948), 18 U.S.C. § 874 (1952). The Copeland Act makes the inducement of kickbacks unlawful. Violation of the act is punishable by a fine of not more than \$5,000 or imprisonment for not more than five years, or both.

245. *Ibid.*

246. 29 C.F.R. § 3.5(e)(1) (1949).

specific permission must be obtained by application to the Secretary of Labor.<sup>247</sup>

### National Labor Relations Act

Under decisions of the United States Court of Appeals for the District of Columbia Circuit and the National Labor Relations Board in *Richfield Oil Corporation v. NLRB*,<sup>248</sup> a savings and investment plan is a mandatory subject of collective bargaining under the National Labor Relations Act.<sup>249</sup>

The provisions of Richfield's plan, which was adopted in July of 1953, are similar in many respects to those contained in savings and investment plans of other companies.<sup>250</sup> Participation is open to all regular employees who have completed at least one year's employment with Richfield and are between thirty and sixty-five. The participants contribute, by way of authorized payroll deduction, a monthly sum of not less than five dollars nor more than five per cent of their earnings for the month. Richfield makes monthly contributions equal to fifty per cent of the contributions made by participants, and an annual contribution whose amount is dependent upon the ratio of profits to invested capital, which could make Richfield's total contribution as much as seventy-five per cent of the participant's contribution.

The contributions of the participants are credited to their individual accounts; company contributions are credited to a trust account maintained for each participant. The trustee is required to

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247. 29 *id.* § 3.5(b). The application should state that the deductions will meet these standards:

(1) That such deduction is not prohibited by other law; and

(2) That such deduction is (i) voluntarily consented to by the employee in writing and in advance of the period in which the work was done, and that consent to the deduction is not a condition either for the obtaining of or for the continuance of employment; or (ii) that such deduction is for the benefit of the employees or their labor organization through which they are represented and is provided for in a bona fide collective bargaining agreement; and

(3) That from such deduction no payment is made to, or profit or benefit is obtained directly or indirectly by the contractor or subcontractor or any affiliated person, and that no portion of the funds, whether in the form of a commission or otherwise, will be returned to the contractor or subcontractor or to any affiliated person; and

(4) That the convenience and interest of the employees are served thereby, and that such or similar deductions have been customary in this or comparable situations.

248. 110 N.L.R.B. 356 (1954) (one member dissenting), *enforcement granted*, 231 F.2d 717 (D.C. Cir.) (one judge dissenting), *cert. denied*, 351 U.S. 909 (1956). For a comprehensive study of the bargainability of stock-purchase plans, see SOBERNHEIM & BROWN, *COLLECTIVE BARGAINING ON STOCK PURCHASE PLANS: WHAT PRICE EMPLOYEE STOCK OWNERSHIP?*, 55 COLUM. L. REV. 1000 (1955).

249. 61 STAT. 136 (1947), as amended, 29 U.S.C. §§ 141-88 (1952).

250. The facts concerning the provisions of Richfield's plan are set forth in 110 N.L.R.B. at 358-59 and 231 F.2d at 719-20.

use the funds in the participant and trust accounts to purchase shares of Richfield's common stock in the open market or by private purchase. The shares so purchased are credited to each participant's account at the end of the calendar quarter in which the stock is acquired. All cash and stock dividends are credited to the respective accounts, the cash dividends being used to purchase additional shares of stock.

No cash or stock may be distributed to anyone while a participant in the plan. At termination of employment at age fifty-five if a man, or at age fifty if a woman, or in the event of death or total and permanent disability, the participant or his beneficiary receives all cash and stock credited to his and the trust accounts. A participant leaving the employ of the company before reaching the above age receives cash and stock attributable to his contributions and a percentage of the stock purchased with the company's contributions, ranging from nothing, if his participation has been less than five years, to all, if his participation has been for ten or more years. If a participant withdraws from the plan and remains an employee of the company, he receives only the stock and cash attributable to his contributions and may not participate in the plan again for two years.

After Richfield announced adoption of the plan, members of the union expressed a desire to meet with company officials for the purpose of negotiating the plan. The company refused to negotiate, but did agree to meet with the union for the purpose of explaining the plan. At these meetings the union proposed certain modifications of the plan which Richfield would not accept. After Richfield flatly refused to bargain with respect to the plan, the union charged Richfield with unfair labor practices.

The Board and the court of appeals held that (1) the plan was embraced by the statutory term "wages" which comprehends all emoluments of value which may accrue to employees because of their employment relationship,<sup>251</sup> (2) the benefits to employees under the plan flow from the employment relationship, (3) the plan was encompassed by the term "other conditions of employment," (4) the requirement

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251. Section 8(a) of the act provides: "It shall be an unfair labor practice for an employer . . . (5) to refuse to bargain collectively with the representatives of his employees subject to the provisions of section 9(a)." 61 STAT. 140 (1947), 29 U.S.C. § 158(a)(5) (1952). Section 9(a) refers to "collective bargaining in respect to rates of pay, wages, hours of employment or other conditions of employment." 49 STAT. 453 (1947), as amended, 29 U.S.C. § 159(a) (1952). In *Inland Steel Co.*, 77 N.L.R.B. 1, *enforcement granted*, 170 F.2d 247 (7th Cir. 1948), *cert. denied*, 336 U.S. 960 (1949), it was held that the benefits which accrue to employees under a retirement and pension plan are wages and a condition of employment. The courts have also held that group health and insurance programs, merit wage increases and profit-sharing plans are within the statutory scope of collective bargaining. *NLRB v. Black-Clawson Co.*, 210 F.2d 523 (6th Cir. 1954); *W. W. Cross & Co. v. NLRB*, 174 F.2d 875 (1st Cir. 1949); *NLRB v. J. H. Allison Co.*, 165 F.2d 766 (6th Cir. 1948).

to bargain the plan did not contravene the policies of the act since collective bargaining would not result in an encroachment upon Richfield's right to control its own business affairs and operations and the disposition of its properties.<sup>252</sup>

With respect to the last conclusion the Board pointed out that the union has no voice under the act in matters where the stockholders only have a right to be heard, such as stockholders meetings and corporate elections.<sup>253</sup> On this issue the court could find no threat to Richfield's maintaining the integrity of its own business ownership or that the situation necessarily involved bargaining about the conditions and prerogatives of ownership.<sup>254</sup>

Richfield contended in the court of appeals that the Board's order violated constitutional rights by depriving the employer of freedom and liberty concerning the disposition of its property in contravention of the fifth amendment, and by superseding the individual employee's freedom of contract in binding employees to purchase stock with funds already earned and owned by them. The court did not agree, asserting that the union sought to speak only for its own bargaining unit, as the act authorizes, with respect to wages and other conditions of employment.<sup>255</sup>

Without deciding that any special problem inevitably necessitates bargaining, the court suggested that agreement by bargaining on a number of issues under Richfield's plan could further the objectives of Congress in passing the National Labor Relations Act. These issues included: (a) what is service for the purpose of determining eligibility; (b) how shall wages be determined upon which to base the percentage of possible contributions; (c) how is continuity of status to be ascertained and preserved; (d) what effect there may be upon the employee's rights to participate in future benefits in the event of strikes or lock-outs; (e) whether a union man on union business may be on leave of absence; or (f) whether undefined company policy shall solely govern the effect of lay-offs upon the employee's right to future benefits.<sup>256</sup>

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252. Richfield based its argument, that the requirement of bargaining was contrary to the basic policies of the act, on the declaration of policy of the act which provides that the purpose of the act is to prescribe the legitimate rights of employees and employers and to provide orderly and peaceful procedures for preventing the interferences by either with the legitimate rights of the other. 61 STAT. 136 (1947), 29 U.S.C. § 141 (1952). Richfield argued that since compulsory collective bargaining concerning the plan could result, through the acquisition of stock by participating employees, in a substantial encroachment upon the employer's right to control his own business affairs and operations, it must be presumed that the act does not require it. 110 N.L.R.B. at 361.

253. *Id.* at 363.

254. 231 F.2d at 721.

255. *Id.* at 722-23.

256. *Id.* at 723.



It has been stated elsewhere that the aspects of the plan which are bargainable would include eligibility under the plan, contributions, vesting period, what constitutes continuous service for acquiring rights under the plan, right of withdrawal of securities purchased under the plan, investments and whether dividends should be paid to the participant or applied to the purchase price of new stock.<sup>257</sup>

### CONCLUSION

As a method of paying compensation the savings and investment type of plan might be criticized on the basis that the amounts paid by the employer are not related to the quality or quantity of services rendered, except insofar as the employer's contributions are determined or limited by the amount of other compensation paid to individual participants. However, in a period when industry is adopting myriad and sometimes weird compensation plans ranging from use of unemployment benefit trusts to provide for lay-off pay for wage-hour employees to the complicated deferred compensation arrangements for executives, the savings and investment plan stands out as a popular and simple way to pay compensation with a minimum of legal uncertainties. Such plans can be tailored to provide for retirement benefits, unemployment security, incentive through profit-sharing or stock interest, deferral of compensation for tax reasons and even death benefits.

Undoubtedly new twists on investment plans will be devised. For example, there is a possibility that a company could develop a plan which would require no cash outlay by the company and yet could provide for a substantial benefit to employees through the use of restricted stock options within the meaning of section 421 of the Internal Revenue Code of 1954. Savings and investment plans are so flexible that the model plan of the future would probably not be recognizable as such by present standards.

The widespread adoption of employee savings and investment plans may have a particularly strong impact on employee outlook. Such plans, keyed as they are to the participation of all employees and encouraging the investment of savings in common stocks, should soon create a vast new class of small stockholders who not only have a stake in the business but who work to produce its profits. This has always been thought a desirable objective so far as key employee personnel are concerned, but never before have lower-paid employees been offered through employer contributions such an inducement to become stockholders.

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257. Sobernheim & Brown, *supra* note 248, at 1030-32.