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Securities Law: The Exclusion of Noncontributory, Compulsory Pension Plans

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SECURITIES LAW: THE EXCLUSION OF NONCONTRIBUTORY, COMPULSORY PENSION PLANS—*International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551 (1979).

INTRODUCTION

Recent Supreme Court decisions[1] have illustrated a trend toward a more restrictive approach to actions brought pursuant to section 10(b)[2] and rule 10b-5[3] of the Securities Exchange Act of 1934. *International Brotherhood of Teamsters v. Daniel,*[4] in which the Supreme Court rejected an expansive reading of the securities laws, is the most recent case exemplifying this trend. The Court in *Daniel* refused to accept the Seventh Circuit's determination that a noncontributory, compulsory pension plan was a "security" within the definition set forth in section 3(a)(10) of the 1934 Act.[5]

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1. *See, e.g.*, Piper v. Chris-Craft Indus., 430 U.S. 1 (1977); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975); United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975).

2. 15 U.S.C. § 78j(b) (1976). Section 10(b) provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. 17 C.F.R. § 240.10b-5 (1979). Rule 10b-5 provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

4. 439 U.S. 551 (1979).

5. 15 U.S.C. § 78c(a)(10) (1976). Section 3(a)(10) of the 1934 Act provides:

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include cur-

FACTS OF THE CASE

John Daniel began employment as a truck driver for a Chicago trucking firm in 1950, and joined Local 705 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen, and Helpers of America the following year. In 1954, Local 705 and Chicago trucking firms successfully negotiated a collective bargaining agreement which resulted in the establishment of a pension plan for all employees represented by the union. Under the plan, employers were required to pay a sum of money per week for each member-employee. The plan was noncontributory on the part of the employees but their participation in the plan was mandatory. Employees could not request an increase in wages in place of the contributions. In order to qualify for pension payments, an employee was required to have twenty years of continuous service. At the time Daniel retired in 1973 he had been employed with the trucking firm for twenty-three years. Upon application for the pension, however, the plan administrator determined he was ineligible because of a 7 month break in service due to a layoff.[6] The board of trustees of the fund refused Daniel's request to waive the continuous service requirement.

Daniel filed a class action suit in the District Court for the Northern District of Illinois against the Teamsters, Local 705, and a trustee of the pension fund. Daniel alleged misstatements and omissions of material facts, which he contended constituted fraud in connection with the sale of a security in violation of section 10(b)[7] and rule 10b-5[8] of the 1934 Act, and section 17(a) of the Securities Act of 1933.[9] Defendants moved to dismiss on the ground Daniel had no cause of action, arguing that the securities laws were inapplicable to noncontributory, compulsory pension plans. The motion was denied, but application for an interlocutory appeal was granted by the district court.[10] The United States Court of Appeals for the Seventh Circuit affirmed the holding of the district court[11] and ruled that Daniel had a

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rency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

6. 439 U.S. 551, 555 (1979).

7. 15 U.S.C. § 78j(b) (1976).

8. 17 C.F.R. § 240.10b-5 (1979).

9. 15 U.S.C. § 77q(a) (1976). Securities law violations were alleged in the first two counts in Daniel's complaint. Count III alleged violation of labor law duties and Count IV alleged common law fraud and deceit.

10. Daniel v. International Bhd. of Teamsters, 410 F. Supp. 541 (N.D. Ill. 1976), *aff'd*, 561 F.2d 1223 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979).

11. Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1231 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979).

cause of action since his interest in the pension fund was a "security" within the meaning of section 2(1) of the 1933 Act[12] and section 3(a)(10) of the 1934 Act.[13] The Seventh Circuit's rationale was that the plan created an investment contract, which constitutes a security within the definition set forth in the securities laws. The court further ruled that there was a sale of a security within the meaning of section 2(3) of the 1933 Act[14] and section 3(a)(14) of the 1934 Act.[15] The Supreme Court granted certiorari and reversed.

DECISION OF THE COURT

The Supreme Court ruled that noncontributory, compulsory pension plans were not within the purview of interests intended to be protected by the federal securities laws.[16] The primary rationale[17] for the decision was that the interest did not constitute an investment contract as it had been defined and analyzed in recent cases.[18] Typically, in order for an interest to qualify as an investment contract, the individual must make an investment of money in a common enterprise, and expect that profits be derived on that investment solely from the efforts of others.[19] The Court, looking at the economic reality of the transaction as a whole, concluded that Daniel did not invest money and that the realization of any profit would not depend primarily on the entrepreneurial ability of the trustee. The Court rejected Daniel's contention that the employer contributed money on his behalf. Rather, it found that there was no fixed relationship between contributions to the fund and the employer's obligation to any one employee. The Court concluded that there was no expectation of profit from a common enterprise because the larger portion of the fund's income came from

12. 15 U.S.C. § 77b(1) (1976).

13. 15 U.S.C. § 78c(a)(10) (1976). The Supreme Court in International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979), consistent with other Supreme Court decisions, determined that the definition of "security" under the 1933 Act is identical to the definition under the 1934 Act. *See, e.g.*, United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 847 (1975); Tcherepnin v. Knight, 389 U.S. 332, 342 (1967).

14. 15 U.S.C. § 77b(3) (1976).

15. 15 U.S.C. § 78c(a)(14) (1976).

16. International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979).

17. The Court gave additional support to its conclusion by relying on Congressional interpretation of proposed amendments relating to pension plans, the previous position of the SEC on the issue, and the enactment of the Employee Retirement Income Security Act (ERISA) of 1974. Each of these considerations suggested that the pension plan should be exempted from securities law regulation, whether or not an interest therein constituted a security under the definition in the securities Acts. It is this author's belief that the determination that the pension plan was not a security was dispositive, and this casenote focuses on that aspect of the Court's decision.

18. *See, e.g.*, United Hous. Foundation, Inc. v. Forman, 421 U.S. 837 (1975).

19. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

employer contributions, rather than from the fund's investment success.[20]

A. Historical Development of the Definition of an Investment Contract as a "Security"

SEC v. C.M. Joiner Leasing Corp.[21] is the seminal case that interpreted what interests would constitute a "security" under the definition given in the 1933 Act.[22] In *Joiner*, the issue facing the Supreme Court was whether oil lease assignments, coupled with promotional offers to drill an exploratory well which contained strong inducement in the expectation of profit, were securities within the purview of the 1933 Act. In ruling that they were securities, the Court pointed out that even where an interest is not readily identifiable in form as a common security interest (i.e. note, bond, stock) it would not necessarily be excluded as a security under the definition in the 1933 Act.[23] Applying a liberal construction[24] to section 2(1) of the statute, the Court said that if the interest had the characteristics of an "investment contract" or "*any* interest or instrument commonly known as a security," it was to be considered as such.[25]

A few years after *Joiner* the Supreme Court, in *SEC v. W.J. Howey Co.*,[26] had to determine whether a land sale contract, warranty deed, and service contract together constituted an investment contract within the meaning of the 1933 Act. Relying on the *Joiner* view of liberal construction, the *Howey* Court formulated a flexible definition of what would constitute an investment contract, intending it to be adaptable to the numerous situations whereby one uses the money of others to invest for profit.[27] The Court defined an investment contract as:

> [A] contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[28]

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20. 439 U.S. at 562 (1979).
21. 320 U.S. 344 (1943).
22. Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1) (1976).
23. 320 U.S. at 351.
24. This is in accord with the position that "the term 'security' [in the Securities Act of 1933 is defined] in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. REP. NO. 85, 73d Cong., 1st Sess. 11 (1933).
25. 320 U.S. at 351 (emphasis added).
26. 328 U.S. 293 (1946).
27. *Id.* at 298.
28. *Id.* at 298-99.

The test of when an investment contract exists was said to be "whether the scheme involves an investment of money in a common enterprise with profits to come soley from the efforts of others."[29] Adhering to the broad interpretation of a "security" in *Joiner* and analyzing the interest under its newly formulated test, the *Howey* Court found the land sale contract, warranty deed, and service contract to be a "security" subject to regulation under the federal securities laws.

Numerous cases followed which required application of the *Howey* test to determine whether various types of interests were investment contracts. In *Tcherepnin v. Knight*,[30] the issue was whether capital shares in a savings and loan association were securities within the meaning of the 1934 Act. The plaintiffs alleged that solicitations mailed to them by the loan association made false and misleading statements concerning the institution and thereby violated section 10(b) of the Securities Exchange Act of 1934[31] and rule 10b-5.[32] The Supreme Court held such interests were securities.[33] The Court, relying on *Howey* and *Joiner*, stated that "form should be disregarded for substance and the emphasis should be on the economic reality."[34] Looking to the economic reality of the situation, the Court saw petitioners as participants in a money lending operation, the success of which depended on the skills and efforts of the management of the savings and loan company.[35] The petitioners would obtain a return on their investment only if the loan company showed a profit; therefore, the interests had all the attributes of an investment contract defined in *Howey*.

In *United Housing Foundation, Inc. v. Forman*,[36] residents of a housing project brought an action against the corporation responsible for controlling the project, for violations of the antifraud provisions of the Securities Acts. The residents contended that the shares of stock which entitled them to lease apartments in the state subsidized, nonprofit housing cooperative were securities within the scope of federal regulation.

In applying the *Howey* test to determine if such an interest was an investment contract, the Supreme Court described the "touchstone" of the test as being "the presence of an investment in a common ven-

29. *Id.* at 301 [hereinafter referred to as the *Howey* test].
30. 389 U.S. 332, 332 (1967).
31. 15 U.S.C. § 78j(b) (1976).
32. 17 C.F.R. § 240.10b-5 (1979).
33. 389 U.S. at 336. *See* note 13 *supra*.
34. *Id.*
35. *Id.* at 338.
36. 421 U.S. 837 (1975).

ture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others."[37] The Court determined that the primary motivation for investment in the cooperative was to acquire a place to live, and not solely for realization of profits.[38] In a subsequent explanation of the *Forman* approach to the *Howey* test, the Second Circuit held that if profit expectation is only an incidental motive then the interest is not an investment contract.[39]

A funnel type progression has transpired over the past thirty years since the commencement of disputes dealing with investment contracts as securities. This progression is best seen by disregarding the outcomes of the cases discussed and looking only at the rationale employed by the Court in reaching each decision.

In *Joiner*, with its "liberal construction" approach, the Court made the investment contract interest somewhat of a catch-all for artful pleaders to bring federal security law claims on virtually any type of interest.[40] *Howey* attempted to put some limitation on interests qualifying as investment contracts by constructing a definition and a test which required an interest to have certain attributes before qualifying as an investment contract. The "economic realities" requirement added by *Tcherepnin* was later used by the *Forman* Court to further limit the interests which qualified as investment contracts. The *Forman* Court said that although an interest may be called a "stock," it does not necessarily qualify as such if the economic realities indicate otherwise.[41] *Forman* also refined the *Howey* test by emphasizing the motivational aspects of investing in the interest, and by requiring that profits from the investment come solely from third party efforts. Over the years the Court has progressively encased the original, virtually unlimited category of investment contracts with refinements, restrictions, and qualifications. In following such a line of case precedent it becomes apparent why the *Daniel* Court decided as it did, within the framework built by *stare decisis*.

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37. *Id.* at 852.

38. *Id.* at 852-53.

39. Grenader v. Spitz, 537 F.2d 612, 618 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976).

40. The language of Justice Jackson in *Joiner* supports this conclusion:

> However, the reach of the Act does not stop with the obvious and commonplace. Novel, uncommon, or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.' "

SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

41. 421 U.S. at 848-49.

B. Analysis of the Court's Rationale

The Supreme Court's decision that noncontributory, compulsory pension plans did not qualify as securities was based primarily on conclusions drawn from an analysis of such funds under the *Howey* test.[42] A more thorough analysis of pension funds, in accordance with the principles set forth in *United Housing Foundation, Inc. v. Forman*,[43] will lend additional support to the Supreme Court's analysis under the elements of the *Howey* test.

One of the primary errors in the Seventh Circuit's analysis in *Daniel*, as pointed out by the Supreme Court, was the appellate court's emphasis on the less important aspects of pension plans rather than the more significant ones.[44] In keeping with *Forman*, the Supreme Court looked at the economic realities of the entire transaction surrounding the pension fund in question.[45] In its determination that the pension fund did not satisfy the "investment of money" element of the *Howey* test[46] the Court centered its analysis on the character of the consideration given in the transaction.[47] In cases in which a particular interest was found to be an investment contract, the investor "chose to give up a specific consideration in return for a separable financial interest with the characteristics of a security."[48] Purchasers of security interests in these cases gave up a definite consideration. Daniel contended he qualified under this requirement since he permitted his employer to contribute money to the fund and have his labor as consideration in return. In rejecting this contention, the Court stated that what Daniel received in consideration for his employment was a total compensation package of which pension benefits were merely a part. The pension benefit was the only part of the package which resembled a security and it could not be separated therefrom.[49]

Further, the Court rejected Daniel's argument that the contributions made by the employer in his behalf were actually consideration for Daniel's own investment in the pension fund. The contributions made by the employer did not satisfy the obligations of particular employees. Rather, employee man-weeks were merely a way to calcu-

42. International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 558 (1979).
43. 421 U.S. 837 (1975).
44. 439 U.S. at 561.
45. *Id.* at 559.
46. *See* note 29 and accompanying text *supra*.
47. 439 U.S. at 559.
48. *Id.; see, e.g.*, Tcherepnin v. Knight, 389 U.S. 332 (1967); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).
49. 439 U.S. at 560.

late the employer's obligation to the pension fund.[50] This was evidenced by the fact that the amount in retirement benefits that any particular employee received was in no way tied to the amount of time he had been employed with the company.[51]

The motivational aspect of the transaction, of foremost importance in *United Housing Foundation, Inc. v. Forman*, was given only brief consideration in *Daniel*. The Court stated that Daniel was selling his labor to obtain a living, not to make an investment for the future.[52] This is analogous to the reasoning of the *Forman* Court, where the primary motivation for purchasing shares of stock in a nonprofit housing cooperative was found to be the acquisition of a place to live, and not the realization of a return on investment. Where investment for profit is only an incidental motive for purchasing an interest, the interest will not be considered an investment contract.[53] Such a determination was easy for the *Forman* Court to make since the expectation of profit on the purchaser's investment was "speculative and insubstantial."[54] Because the amount of the pension benefits received may be quite substantial,[55] however, it is not as obvious that the pension interest in *Daniel* was not purchased for investment purposes, and a more thorough discussion of the motivational aspect is warranted.

An analysis of *United Housing Foundation, Inc. v. Forman*[56] helps flesh out the *Daniel* Court's reasoning that plaintiffs such as John Daniel are primarily motivated by the need to earn a livelihood and not by the expectation of profits.

To determine whether investment for profit is the primary motivation or purely incidential, *Forman* and other courts have often looked to the emphasis given to profit expectation in brochures used to promote the interest.[57] In *Forman*, the contents of the Information Bulletin distributed to prospective purchasers of apartments left no doubt that the primary motivation was to acquire a place to live and

50. *Id.* at 560-61.
51. *Id.* at 561.
52. *Id.* at 560.
53. Grenader v. Spitz, 537 F.2d 612, 618 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976).
54. United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 856 (1975).
55. *See Daniel v. International Bhd. of Teamsters*, 561 F.2d 1223, 1234 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979).
56. 421 U.S. 837 (1975).
57. *See, e.g.*, Davis v. Rio Rancho Estates, Inc., 401 F. Supp. 1045, 1050 (S.D.N.Y. 1975)(residential aspects more pronounced than investment aspect); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 348 (1943)(court placed so much importance on economic inducements contained in the promotional material that if the proposal had not advertised the profits that may be expected from drilling of the exploration well, the interest in leasehold rights may not have been considered a security).

not to realize a return on investment.[58] The Bulletin in no way attempted to make the profit aspect a highlight of the purchase. In fact, as the *Forman* Court noted, "the Bulletin repeatedly emphasizes the 'nonprofit' nature of the endeavor."[59] Likewise, the matters expressed in the Local Union's plan booklet did not present enrollment in the pension plan in *Daniel* as a profitable investment scheme. The language in the cover letter contained in the plan booklet merely states the purpose and nature of the pension fund.[60] The contents were hardly the

58. 421 U.S. at 853.

59. *Id.* at 854.

60. The following is an excerpt from the cover letter preceding the Local 705 plan booklet:

Dear Sir and Brother:

You and your family, including unmarried children up to 18 years of age, are protected by Local 705, International Brotherhood of Teamsters, Health and Welfare Fund and Local 705 International Brotherhood of Teamsters Pension Trust Fund. The rules and regulations of the respective funds are contained in this booklet. The purpose of these Funds is to take care of you and your family in case of illness, disability, accident, retirement, or death.

It is during those times that you and your family need the greatest amount of help because illness deprives the family of their breadwinner and his earnings. These plans were designed as far as we possibly could go subject to the Taft-Hartley Law in protecting you and your family. We would have like [*sic*] to have done more, but we were limited by both the laws and the amount of contribution paid into the Funds. It is useless to promise you benefits when the Funds will be unable to pay them, and therefore, the Trustees have designed this plan so that they will pay the highest amount of money possible consistent with solvent and workable Funds. Under the law the Funds must be administered jointly by an equal number of Employer and Union representatives and therefore the Union does not have the full say as to how the Fund shall be run or what benefits shall be paid. It must be done jointly with the Employers. Only in the event of a deadlock among Trustees does the law provide for the appointment of an impartial Trustee to break the deadlock.

The Trustees at all times have the right to make all necessary and proper changes which they believe are necessary for the protection of the members and the Fund, and these rules and regulations which are set forth in this pamphlet are subject to this understanding and limitation . . . .

Exhibit 1D, 1958 Local 705 Health & Welfare and Pension Funds Booklet, p.1, Motion of Defendants Local 705, etc., and Louis F. Peick to Dismiss Complaint, International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979). Compare the language and tone of the plan booklet cover letter in *Daniel* to the advertising literature used in SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943), which was the primary basis for the *Joiner* Court's determination that oil lease assignments in that case were securities:

We are pleased to report our Concho County well drilling at approximately 2510 feet in a very good formation. We are sending out 800 feet of 8¼ inch casing to be run in the McCulloch County well tomorrow. Both wells should be completed during next month . . . . This offer goes to you who now have a lease around one or both of these locations, and also to you who have at some time invested in a lease or leases around some well that the C.M. Joiner Interests have drilled. . . . we are submitting this proposition to you in language that will appeal only to business people who are interested in making an investment where they have a good chance for splendid returns on the investment. There has nothing happened

"hawking siren song of the promoter,"[61] designed to induce employees to take on, or remain in employment primarily because of the profits they would realize as a result of participation in the pension plan aspect of the compensation package.

Another aspect of motivation recognized by the *Forman* Court is that the investor must be motivated by the anticipation of profit returns on the investment, rather than by the "desire to use or consume the item purchased."[62] The *Daniel* Court found that John Daniel was in the latter category, stating that he was "selling his labor to obtain a livelihood," and "not making an investment" on which profits would be realized.[63] The pension payments Daniel and other employees expect to receive upon retirement are in no way analogous to the "profit" an investor is required to anticipate under *Forman* standards. Participants in noncontributory, compulsory pension plans do not expect a profit from the employer's contribution to the fund. Rather, they expect to receive retirement benefits and do not particularly care how those benefits are derived, whether from profits by investment or from employer contributions.[64] The economic reality is that the payments received under the pension plan are, in substance, deferred compensation to the employee for the years of service given to his employer.

The second prong of the *Howey* test considered by the *Daniel* Court was the requirement that expected profits be from a common enterprise.[65] Typically, courts have put a restriction on the term "profits" by requiring that they be of the type "traditionally associated with securities."[66] The *Forman* Court listed two types of profits that would qualify as being the "capital appreciation resulting from the development of the initial investment, . . . or . . . a participation in

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to either of these wells that would lessen the prospects for the opening of a new oil field. . . . We feel that if we are to get the law of average that one or both these wells should be producers. I know you would like the thrill that comes to those owning a lease around a producing well. . . . If you send in an order for twenty acres . . . you will get ten acres Free in the next block of acreage we drill which is most likely to be in Concho County, Texas. You will really be in the oil business. Remember, if *you* do not make money on your investment it will be impossibile for us to make money. . . . Fortunes made in oil go to those who invest. We believe you should invest here, and now!

Id. at 346-47, n.3.

61. Grenader v. Spitz, 537 F.2d 612, 618 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976).

62. 421 U.S. at 852-53.

63. 439 U.S. at 560.

64. Alef & Short, *Problems created by CA-7 decision that pension plan participation is a security*, 47 J. TAX. 282, 283 (1977).

65. 439 U.S. at 561.

66. United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 854 (1975).

earnings resulting from the use of investors' funds."[67] In viewing the retirement payment or employee return from the pension fund, the *Daniel* Court noted that only a small portion of the assets from the pension fund are of the types set forth in *Forman*. The greater portion of the assets available for payment are from nontraditional sources such as " 'pooled' contributions of all participating employers, forfeitures of employees whose pension rights do not vest or . . . increased contributions negotiated by the union."[68]

Further support for finding that the pension fund did not satisfy the second prong of the *Howey* test is found by considering the "touchstone" of the test, as expressed in *Forman*, that profits be derived from the entrepreneurial or managerial efforts of others.[69] The investment activities of the third party manager have been given much emphasis in cases deciding the qualification of certain interests as investment contracts.[70] Concerning this aspect of the *Howey* test the *Daniel* Court had another occasion to point out the Seventh Circuit's failure to view the economic realities of the entire transaction. Although the managerial and entrepreneurial efforts of the trustees of a noncontributory pension fund do result in an increase in earning on its assets, they play an insignificant part in the fund's total income. A far larger portion comes from employer contributions to the fund.[71] In addition, unlike most entrepreneurs who invest other peoples' money, the pension fund trustee can count on increases in contributions to make up for losses in earnings.[72]

The noncontributory, compulsory pension plan is further set apart from the typical security interest because the trustees' investment success is not the primary factor in the employee receiving his retirement

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67. *Id.* at 852.

68. Petitioner's Brief for Certiorari at 18, International Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979). For a comprehensive analysis of this area see Note, *The Application of the Antifraud Provisions of the Securities Laws to Compulsory, Noncontributory Pension Plans After Daniel v. International Brotherhood of Teamsters*, 64 VA. L. REV. 305 (1978) [hereinafter called *Application of Antifraud Provision*].

69. 439 U.S. at 561 (citing United Hous. Foundation, Inc. v. Forman, 421 U.S. 837, 852 (1975)).

70. *See, e.g.*, Grenader v. Spitz, 537 F.2d 612 (2d Cir.), *cert. denied*, 429 U.S. 1009 (1976). In the *Forman* context, efficient management of an apartment complex would not be a dominant factor that would increase the value of the shares of stock. The third party's efforts might result in a more pleasant place to live. But the outside influences of housing demand in the neighborhood and the availability of credit would be the primary factors determining whether or not a profit would result.

71. 439 U.S. at 562 (Through investment of its assets between February, 1955 and January, 1977, Local 705 Fund earned a total of $31 million, while employer contributions totaled $153 million).

72. *Id.* (citing Note, *Application of Antifraud Provisions, supra* note 68).

benefits. Rather, the primary determinant is whether the employee has fulfilled the vesting requirements.[73]

By considering the economic realities of the entire transaction, the *Daniel* Court's decision is logically consistent with the principles set forth in *Forman*. The decision also fits within the funnel-type progression which has evolved from Supreme Court cases dealing with investment contracts as securities. The Court's decisions in this area over the past thirty years have had the effect of limiting the scope of the securities laws in general, by narrowly construing the definition of an "investment contract" as a "security." At the same time, *Daniel* has a similar effect in specifically narrowing the scope of section 10(b) and rule 10b-5.[74] While the previous analysis demonstrates that the Court came to the proper decision based on prior cases dealing with the qualification of the pension interest as a "security," it is helpful in understanding *Daniels* broader impact on the extent of relief available under the securities laws, to consider this secondary and rather harsh effect.[75]

C. Policy Considerations in the Background of Judicial Thought When Limiting 10b-5 Actions

In *Blue Chip Stamps v. Manor Drug Stores*,[76] plaintiffs brought an action for violation of the anti-fraud provisions of section 10(b) of the Securities Exchange Act of 1934[77] and rule 10b-5,[78] in connection with an allegedly misleading prospectus given them by the defendant stamp company. Plaintiffs alleged that because of their reliance on the overly pessimistic prospectus they failed to purchase the offered units of stock in Blue Chip.[79] The Supreme Court had to determine whether

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73. 439 U.S. at 562 (citing Note, *Interest in Pension Plans as Securities: Daniel v. International Brotherhood of Teamsters*, 78 COLUM. L. REV. 184, 201 (1978). *See also* Alabama Power Co. v. Davis, 431 U.S. 581 (1977). In support of the contention that the employees own activities are the primary reason for receiving profits the Supreme Court, in *Davis*, said "that the 'true nature' of the pension payment is a reward for length of service." *Id.* at 593.

74. John Daniel brought suit against the Teamsters, Local 705 and a trustee of the pension fund alleging fraud in connection with the sale of a security in violation of § 10(b) and rule 10b-5 of the 1934 Act. 439 U.S. at 55. *See* note 7-9 *supra*.

75. John Daniel, being denied relief under the 1933 and 1934 Acts, has no remedy available under federal law. He has no cause of action under the Employee Retirement Income Security Act (ERISA) of 1974, Pub. L. No. 93-406, § 1, 88 Stat. 829 (1974) (codified in scattered sections of titles 5,16,26,29,31,42 U.S.C.), because that federal act took effect after he had retired. 439 U.S. at 569.

76. 421 U.S. 723 (1975).

77. 15 U.S.C. § 78j(b) (1976).

78. 17 C.F.R. § 240.10b-5 (1979).

79. 421 U.S. at 726-27.

plaintiffs had a private cause of action under the securities laws where they were neither purchasers nor sellers of the securities. The *Blue Chip* Court reaffirmed the longstanding *Birnbaum*[80] rule that in order for a party to maintain an action under rule 10b-5 they must have been actual sellers or purchasers of the security.[81] The result of adopting the *Birnbaum* rule was to narrow the number of potential actions that might be brought pursuant to rule 10b-5, effectively leaving a class of plaintiffs without relief in the federal courts. In rationalizing the decision, Justice Rehnquist relied on legislative history, the statutory scheme, and case precedent. Consideration of the policy against vexatious litigation, however, was the primary basis for the decision.[82] In fact, Justice Rehnquist said that if the *Birnbaum* restriction had no "countervailing advantages it would be undesirable as a matter of policy, however much it might be supported by precedent and legislative history."[83] The policy concern expressed in *Blue Chip* has also been used by other courts whose decisions likewise had the effect of restricting suits under rule 10b-5.[84]

The *Blue Chip* Court's major policy concern stemmed from a fear of vexatious litigation that could result from widely expanding the class of plaintiffs under 10b-5 actions.[85] More so than other types of litigation, actions under rule 10b-5 have a high potential of being "nuisance" suits. In a "nuisance" or "strike" suit a party may institute an action which would have little merit at trial, but which may prove beneficial in precipitating an out of court settlement.[86] Such suits can unduly delay the normal business activities of corporate defendants, with a substantial amount of time being devoted to

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80. Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952).

81. 421 U.S. at 731.

82. 421 U.S. 723 (1975). Justice Blackmun, in his dissenting opinion, said "the greater portion of the Court's opinion is devoted to its discussion of the 'danger of vexatiousness,' *ante*, at 739, that accompanies litigation under Rule 10b-5 . . ." *Id.* at 769. Justice Rehnquist had indicated that "[g]iven the peculiar blend of legislative, administrative and judicial history which now surrounds Rule 10b-5, we believe that . . . [policy considerations] are entitled to a good deal of weight." *Id.* at 749. *See also* Note, *Standing Under Rule 10b-5 After Blue Chip Stamps*, 75 MICH. L. REV. 413, 422-23 (1976)(primary basis for *Blue Chip* affirming *Birnbaum* was fear of vexatious litigation).

83. 421 U.S. at 739.

84. *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462 (1977); *see also* Lowenfels, *Recent Supreme Court Decisions Under the Federal Securities Laws: The Pendulum Swings*, 65 GEO. L.J. 891, 900-01 n.57 (1977)(suggests other courts may rely on the concerns expoused in *Blue Chip* as factors to help determine whether to restrict the scope of 10b-5 actions).

85. 421 US. at 740.

86. *Id.*

discovery procedures, all at the instance of plaintiffs who may have groundless claims.[87] Without the limitation of 10b-5 actions there is also the danger of throwing "open to the trier of fact many rather hazy issues of historical fact the proof of which [may depend] almost entirely on oral testimony."[88] The *Blue Chip* Court expressed the concern that the effect of the alleged deceptive practices in that case would be totally dependent on the plaintiff's own recollection that he did consult the prospectus and that he chose not to purchase the stock in reliance thereon.[89] Such testimony would be virtually impossible to refute.

A similar situation arises in a *Daniel* context. In his affidavit Daniel contended that the retirement plan was a material factor in continuing his employment over a twenty-three year period.[90] Additionally, had he known of the requirement concerning uninterrupted service, he alleged he would have sought employment elsewhere.[91] These are facts which are peculiarly within the knowledge of Daniel and the evidence of such would be uncorroborated. The spectre of a plaintiff's case resting largely on oral testimony, and the potential for "nuisance" suits, are legitimate concerns upon which the *Daniel* decision finds additional support.

CONCLUSION

The *Daniel* Court refused to extend coverage of the securities laws to noncontributory, compulsory pension plans. A significant effect of *Daniel* is that it precludes recovery under the securities laws to plaintiffs with claims relating to fraudulent activities in connection with such pension plans. The decision is consistent with case precedent in the area of investment contracts as securities. Historically, the trend has been one of restricting the types of interests which will come under protection of the securities laws via the investment contract route. An analysis of the facts in *Daniel* under the tests and rationales set forth in earlier cases indicate why the Court reached the decision that it did. Moreover, the various factors considered by the *Blue Chip* Court are also helpful in understanding the *Daniel* effect of restricting the scope of rule 10b-5.

The significance to the individual plaintiff, John Daniel, is that he is left without recourse under federal law. This result may appear

87. *Id.* at 741.
88. *Id.* at 743.
89. *Id.* at 746.
90. Daniel v. International Bhd. of Teamsters, 561 F.2d 1223, 1227 (7th Cir. 1977), *rev'd*, 439 U.S. 551 (1979).
91. *Id.*

somewhat unjust considering that Daniel is part of a very small and specific group of potential plaintiffs. Other individuals who subsequently have claims arising in connection with similar pension plans will have federal recourse via ERISA.[92] It was merely the fortuitous event of Daniel's retirement before ERISA took effect that precludes him from a federal law remedy. The harshness of this result is somewhat attenuated by the fact that, although he is precluded from protection under federal regulations, Daniel does have other recourse available to him, including remedies under state law for violation of state securities laws or in a state court civil action for common law deceit.[93]

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92. *See* note 75 *supra*.

93. K. BIALKIN, THE 10B SERIES OF RULES 24-25 (Corporate Practice Transcript Series No. 21, 1975).