

The Definition of Security: *Marine Bank v. Weaver*¹ — The Securities Act of 1933² and the Securities Exchange Act of 1934³ regulate transactions involving securities.⁴ While applicability of the securities acts' regulations⁵ therefore re-

¹ 455 U.S. 551 (1982).

² 15 U.S.C. §§ 77a-77aa (1976 & Supp. II 1978).

³ 15 U.S.C. §§ 78a-78kk (1976 & Supp. II 1978).

⁴ See Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976 & Supp. II 1978) and Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976 & Supp. II 1978). The primary purpose of the Securities Act of 1933 and the Securities Exchange Act of 1934 was to eliminate serious abuses in a largely unregulated securities market. *United Housing Found. Inc. v. Forman*, 421 U.S. 837, 849 (1975). The Senate Report on the bill that became the Securities Act of 1933 stated:

The purpose of this bill is to protect the investing public and honest business. The basic policy is that of informing the investor of the facts concerning securities to be offered for sale in interstate and foreign commerce and providing protection against fraud and misrepresentation.

The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation, to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.

S. REP. NO. 47, 73d Cong., 1st Sess. 1 (1933) *reprinted in* 2 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, Item 17.1 (J. Ellenberger and E. Mahar eds. 1973).

President Roosevelt, in his 1934 message to Congress proposing securities legislation, stated:

I recommend to the Congress the enactment of legislation providing for the regulation by the Federal Government of the operations of exchanges dealing in securities and commodities for the protection of investors, for the safeguarding of values, and so far as it may be possible, for the elimination of unnecessary, unwise, and destructive speculation.

S. REP. NO. 792, 73d Cong., 2d Sess. 1 (1934), *reprinted in* 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, Item 17.1 (J. Ellenberger and E. Mahar eds. 1973).

For a scholarly examination of theories connecting the 1929 stock Market Crash with abuses in the stock market, see generally FitzGibbon, *What is a Security? — A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 MINN. L. REV. 893, 912-18 (1980) [hereinafter cited as FitzGibbon].

⁵ Two examples of the protection afforded by the federal securities acts' regulations are § 17(a) of the Securities Act of 1933 and § 10(b) of the Securities Exchange Act of 1934. Section 17(a) of the 1933 Act (currently codified as 15 U.S.C. § 77 q(a) (1976)) provides in pertinent part:

It shall be unlawful for any person in the offer or sale of any securities . . . directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

15 U.S.C. § 77q(a) (1976).

quires that the transaction involve a security,⁶ what constitutes a security is often unclear due to the acts' broad and ambiguous definitions.⁷ The breadth and ambiguity of the securities acts' definitions are attributable to the use of such indefinite statutory language as, "unless the context otherwise requires," "an instrument commonly known as a security," and an "investment con-

Courts of appeals disagree over whether a private cause of action exists under section 17(a) of the Securities Act of 1933. Compare *Stephenson v. Calpine Conifers II, Ltd.*, 652 F.2d 808, 815 (9th Cir. 1981) (holding that a private cause of action exists under § 17(a)) and *Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978), *reh'g denied*, 603 F.2d 234 (2d Cir. 1978), *reh'g en banc denied*, 603 F.2d 234 (2d Cir. 1978), *cert. denied*, 442 U.S. 909 (1979) (holding that a private cause of action exists under § 17(a)) with *Shull v. Dain, Kalman & Quail*, 561 F.2d 152, 159 (8th Cir. 1977), *reh'g denied*, 561 F.2d 152 (8th Cir. 1977) (holding that no private cause of action exists under § 17(a)). Section 10(b) of the 1934 Act (currently codified as 15 U.S.C. § 78 (1976)) provides in pertinent part:

It shall be unlawful for any person, directly or indirectly, by 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.

15 U.S.C. § 78 (1976).

It is well established that a private cause of action exists under § 10(b) of the Securities Exchange Act of 1934. See, e.g., *Superintendent of Ins. v. Bankers Life and Casualty Co.*, 404 U.S. 6, 13 n.9 (1971) (dicta). Nevertheless, the Court has never expressly held that such a cause of action exists. See Casenote, *A Scintilla Requirement for SEC Injunctions Under 10(b) — Investor Protection Under the Securities Laws is Further Restricted*, *Aaron v. SEC*, 22 B.C.L. REV. 595, 595-96, n.7 (1981).

⁶ See generally, Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1976 & Supp. II 1978); Securities Exchange Act, 15 U.S.C. §§ 78a-78kk (1976 & Supp. II 1978).

⁷ The statutory definitions of "security" provided by these acts are virtually identical. *Tcherepnin v. Knight*, 389 U.S. 332, 335-36, 342 (1967). The Securities Act of 1933 defines "security" as follows:

When used in this subchapter, unless the context otherwise requires —

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

Securities Act of 1933 § 2(1), 15 U.S.C. § 77b (1976).

The Securities Exchange Act of 1934 defines "security" as follows:

(a) When used in this chapter, unless the context otherwise requires — . . .

(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 currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the

tract.”⁸ In response to this indefinite statutory language, the Supreme Court of the United States has repeatedly attempted to clarify what instruments qualify as securities.⁹ Recently, in *Marine Bank v. Weaver*,¹⁰ the Court again considered the meaning of security within the acts’ ambit, and articulated its narrowest construction yet for what instruments qualify for protection under the securities laws.¹¹

Prior to *Marine Bank*, the Supreme Court considered a number of cases raising the question of what instruments were securities for purposes of the securities acts.¹² The term “investment contract,” in particular has been the focus of a great deal of litigation in the Supreme Court.¹³ In an early decision,¹⁴ the Court initially indicated that instruments qualified as investment contracts — and thus “securities” — if they were widely offered or dealt in under terms or courses of dealing which established their “character in commerce” as investment contracts,¹⁵ or as any interests or instruments commonly known as securities.¹⁶ Subsequently, the Court modified this “character in commerce” test and established what has since been considered the classical test.¹⁷ This

time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1976).

⁸ *Id.* In particular, the term “investment contract” has been employed by the courts as a “catch-all” *See*, 1 L. LOSS, SECURITIES REGULATION, 483-511 (2d Ed. 1961), [hereinafter cited as LOSS].

⁹ *See, e.g.*, *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 558-70 (1979) (holding employee’s participation in compulsory pension plan not an “investment contract” and therefore not a security); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 847-60 (1975) (holding shares of stock purchased by tenants of publicly financed low-income housing projects as prerequisite for occupancy, not “investment contracts” and therefore not securities); *Tcherepnin v. Knight*, 389 U.S. 332, 335-46 (1967) (holding withdrawable capital shares of savings and loan association to be securities); *SEC v. Variable Annuity Life Ins. Co.*, 359 U.S. 65, 67-73 (1959) (holding variable annuity contracts to be securities); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297-301 (1946) (holding sales contracts for units of citrus grove development coupled with contracts to service citrus trees to be “investment contracts” and therefore securities); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351-55 (1943) (holding contracts to sell assignments of oil leases containing economic inducements of proposed exploration wells to be securities).

¹⁰ 455 U.S. 551 (1982).

¹¹ *See infra* notes 204-26 and accompanying text.

¹² *See supra* note 9.

¹³ *See, e.g.*, *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 558-70 (1979); *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 851-55 (1975); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 297-301 (1946); *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351-55 (1943).

¹⁴ *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943).

¹⁵ The elastic term “investment contract” appears in the statutory definition of “security” in both the Securities Act of 1933 and the Securities Exchange Act of 1934. *See supra* note 7.

¹⁶ *SEC v. C.M. Joiner Leasing Corp.* 320 U.S. 344, 351 (1943). For a further discussion of the *C.M. Joiner Leasing Corp.* test, *see infra* notes 64-76 and accompanying text.

¹⁷ *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946). Courts considering securities cases have generally relied on the *Howey* characterization of an “investment contract.” *See, e.g.*, *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 558-59 (1979); *United Hous. Found., Inc. v. Forman* 421 U.S. 837, 852 (1975); *Tcherepnin v. Knight*, 389 U.S. 332, 338 (1967); *Canadian Imperial Bank of Commerce Trust Co. v. Fingland*, 615 F.2d 465, 469 (7th Cir. 1980); *Brodt v. Bache & Co.*, 595 F.2d 459, 462 (9th Cir. 1979); *Grenader v. Spitz*, 537 F.2d 612,

classical test states that an instrument is an "investment contract," and thereby constitutes a security, if it is a contract, transaction or scheme whereby an individual invests money in a common enterprise with the expectation of gaining profits solely through the efforts of others.¹⁸ This test was subsequently narrowed by the addition of three requirements.¹⁹ First, the profits sought had to result from the *entrepreneurial* or *managerial* efforts of someone other than the individual investor.²⁰ Second, the profits sought could not take the form of a commodity for personal consumption.²¹ Finally, there had to be a separable element constituting consideration for the security.²² This refined classical test was not modified again until *Marine Bank*.

In *Marine Bank v. Weaver*,²³ the Supreme Court further narrowed the classical test of what qualified as an investment contract/security as defined by the federal securities acts, by imposing two additional requirements.²⁴ First, the security must retain an element of risk such that the investment may result in loss.²⁵ Second, the security cannot be too unique.²⁶ The facts of *Marine Bank* were largely undisputed.²⁷ Beginning in 1976, *Marine Bank*²⁸ made three loans to Columbus Packing Company, an unincorporated wholesale slaughterhouse and retail meat market owned as a proprietorship by Raymond and Barbara

618-19 (2d Cir. 1976), *cert. denied*, 429 U.S. 1009 (1976); Safeway Portland Employees Fed. Credit Union v. C.H. Wagner & Co., 501 F.2d 1120, 1123 (9th Cir. 1974); SEC v. Continental Commodities Corp., 497 F.2d 516, 521 (5th Cir. 1974); SEC v. Glenn W. Turner Enterprises, Inc., 474 F.2d 476, 481 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973); United States v. Herr, 338 F.2d 607, 609-10 (7th Cir. 1964), *cert. denied*, 382 U.S. 999 (1966); Roe v. United States, 287 F.2d 435, 438 (5th Cir. 1961), *cert. denied*, 368 U.S. 824 (1961); Wolf v. Banco Nacional de Mexico, 459 F. Supp. 841, 846 (N.D. Cal. 1982); Troyer v. Karcagi, 476 F. Supp. 1142, 1147 (S.D. N.Y. 1979); Hamblett v. Board of Sav. & Loan Ass'ns, Inc., 472 F. Supp. 158, 165 (N.D. Miss. 1979); Hendrickson v. Buchbinder, 465 F. Supp. 1250, 1252 (S.D. Fla. 1979); Sunshine Kitchens v. Alanthus Corp., 403 F. Supp. 719, 720-21 (S.D. Fla. 1975); SEC v. Orange Grove Tracts, 210 F. Supp. 81, 83 (D. Mass. 1962).

In *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, (1975), the Supreme Court noted that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security." *Id.* at 852.

¹⁸ SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). For an examination of *Howey*, see *infra* notes 77-106 and accompanying text.

¹⁹ The test was narrowed by the Court's holdings in *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 550-60 (1979) and *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 855, 858 (1975). For a discussion of these two cases, see *infra* notes 105-63 and accompanying text.

²⁰ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 855 (1975).

²¹ *Id.* at 858.

²² *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-60 (1979).

²³ 455 U.S. 551 (1982).

²⁴ *Id.* at 557-60. For an examination of *Marine Bank* demonstrating that the Court added two requirements — risk and uniqueness — to the *Howey* test, see *infra* notes 164-203 and accompanying text.

²⁵ *Id.* at 557-59.

²⁶ *Id.* at 559-60.

²⁷ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

²⁸ *Marine Bank* was a federally regulated bank. *Marine Bank v. Weaver*, 455 U.S. at 558.

Piccirillo.²⁹ The loans were secured by perfected security interests in several of the company's business assets and second mortgages on two pieces of real estate.³⁰ Early in 1978, a newly-appointed branch manager of Marine Bank designated the loans as "concerned loans" because he did not believe that Columbus Packing had adequate cash flow and because the proprietorship had no set repayment program.³¹ In addition to the outstanding loans, the proprietorship had a substantial overdraft position with the bank.³² Consequently, Marine Bank informed Mr. Piccirillo that it would levy on the collateral unless the Piccirillos either sold the business and paid the bank, closed the business and sold its assets to pay the bank, or secured additional capital.³³

Rather than follow through on this course of action, however, the bank executed a new agreement with the Piccirillos on March 17, 1978.³⁴ By the terms of this agreement, Marine Bank loaned Columbus Packing \$65,000 on a secured demand note signed by the Piccirillos.³⁵ As additional security, the bank accepted a guarantee agreement signed by a farming couple, Sam and Alice Weaver,³⁶ guaranteeing payment of the Piccirillo's debt to a maximum of \$50,000.³⁷ The Weavers secured the guarantee agreement by pledging³⁸ to

²⁹ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.* The note was secured as the previous loan had been. *Id.* See *supra* text accompanying note 30 for security interest pledged.

³⁶ Neither Mr. Weaver nor Mrs. Weaver, aged 79 and 71 respectively, had any formal education beyond the eighth grade. *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

³⁷ *Id.*

³⁸ The Weavers brought suit in federal court under the anti-fraud provisions of § 10(b) of the Securities and Exchange Act of 1934. *Marine Bank v. Weaver*, 455 U.S. 551, 554 (1982). To meet the threshold requirements of § 10(b), the Weavers alleged — in addition to alleging that a certificate of deposit is a security — that the pledge of the security is a sale of a security. *Weaver v. Marine Bank*, 637 F.2d 157, 160 (3d Cir. 1980) *rev'd* 455 U.S. 551 (1982). Section 10(b) of the Securities Exchange Act of 1934 requires that there be a *purchase* or *sale* of a security. See *supra* note 5 for text of § 10(b). See also *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730-31 (1975) (holding only purchasers or sellers of securities have standing to sue under § 10(b)). The Supreme Court has held that a pledge of stock is equivalent to a sale for purposes of the Securities Act of 1933. *Rubin v. United States*, 449 U.S. 424, 431 (1981). Moreover, in a footnote in *Marine Bank*, the Court, while not deciding the issue, implied that *Rubin* applies to both the Securities Act of 1933 and the Securities Exchange Act of 1934 by stating that "[we] held in *Rubin v. United States* . . . that a pledge of stock is equivalent to a sale for the purposes of the antifraud provisions of the *federal securities laws*."⁹⁹ *Marine Bank v. Weaver*, 455 U.S. at 554 n.2 (emphasis added). Nonetheless, the issue of whether a pledge is a sale for purposes of the Securities Exchange Act of 1934 is unresolved. Compare *Weaver v. Marine Bank*, 637 F.2d 157, 163-64 (3d Cir. 1980), *rev'd* on other grounds, 455 U.S. 551 (1982) and *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1028-30 (6th Cir. 1979) and *Mallis v. Federal Deposit Ins. Corp.*, 568 F.2d 824, 828-30 (2d Cir.), *cert. granted sub nom. Bankers Trust Co. v. Mallis*, 434 U.S. 928 (1977), *cert. dismissed as improvidently granted*, 435 U.S. 381, 388 (1978) (all holding pledge is a "sale" under Securities Exchange Act of 1934) with *Lincoln Nat'l Bank v. Herber*, 604 F.2d

Marine Bank a \$50,000 certificate of deposit issued by the bank to them.³⁹ In consideration for the loan guarantee, the Piccirillos promised to pay the Weavers \$100 per month plus 50 percent of Columbus Packing's "adjusted net profits."⁴⁰ The agreement between the Piccirillos and the Weavers also provided that the Weavers could use the barn and pastures of the slaughterhouse at the Piccirillos' discretion, and that the Weavers could veto future loans to the slaughterhouse.⁴¹

The proceeds of the \$65,000 loan were used by the Piccirillos to repay slaughterhouse loans and overdraft obligations to the bank totaling approximately \$42,000, to pay past due obligations to trade creditors and to pay federal back taxes.⁴² The remaining working capital after these expenses totaled approximately \$3,800.⁴³ Four months after entering into this arrangement, Columbus Packing filed a petition for bankruptcy.⁴⁴ Since the assets of Columbus Packing and the Piccirillos serving as security were inadequate to cover the amount of the loan outstanding,⁴⁵ the bank expressed its intent to realize its claim against the Weavers' certificate of deposit to recover the deficiency.⁴⁶ In response, the Weavers brought suit in the United States District Court for the Western District of Pennsylvania.⁴⁷ The Weavers alleged that by soliciting the loan guarantee while knowing, but not disclosing, Columbus Packing's financial plight or Marine Bank's plans to repay itself from the guaranteed loan,⁴⁸

1038, 1040-45 (7th Cir. 1979) (holding pledge not a "sale" under Securities Exchange Act of 1934) and *National Bank of Commerce v. All Am. Assurance Co.*, 583 F.2d 1295, 1298-1300 (5th Cir. 1978) (arguing pledge not a "sale" under Securities Exchange Act of 1934). For an analysis of whether a pledge constitutes a sale under the 1934 Act see Casenote, *New Protection for Defrauded Pledges of Securities Under Federal Securities Laws: Rubin v. United States*, 23 B.C.L. REV. 821 (1982). See also, Note, *A Pledge of Stock in a Commercial Loan: "Purchase or Sale" Under the Securities Exchange Act of 1934?*, 1979 ARIZ. ST. L. J. 669 (1979); Note, *Applicability of Rule 10b-5 to Pledges of Securities*, 68 CALIF. L. REV. 547 (1980); Case Comment, *Caveat Lender-Federal Securities Law Does Not Apply to a Commercial Loan Secured by a Pledge of Securities*, *Lincoln National Bank v. Herber*, 604 F.2d 1039 (7th Cir. 1979), 56 CHI-KENT L. REV. 1227 (1980); Case Comment, *Pledge of Securities as Loan Collateral Does Not Constitute a "Sale" as Required by Antifraud Provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934: Lincoln National Bank v. Herber*, 604 F.2d 1039 (7th Cir. 1979), 11 CUM. L. REV. 237 (1980).

³⁹ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

To purchase the certificate of deposit from Marine Bank's Corry branch, the Weavers withdrew \$50,000 from another bank. *Id.* The certificate of deposit was payable in six years and bore interest at 7½%. *Marine Bank v. Weaver*, 455 U.S. 551, 552-53, n.1.

⁴⁰ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd* 455 U.S. 551 (1982).

⁴¹ *Marine Bank v. Weaver*, 455 U.S. at 560.

⁴² *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ For security interest pledged see *supra* text accompanying note 30.

⁴⁶ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

⁴⁷ *Id.* at 157.

⁴⁸ 455 U.S. at 554 (1982). The Weavers claimed that pendant jurisdiction empowered the federal district court to hear their state law claims against Marine Bank. *Id.*

Marine Bank had committed common law fraud⁴⁹ and had violated the anti-fraud provisions of both the Securities Exchange Act of 1934⁵⁰ and the Pennsylvania Securities Act.⁵¹ The district court entered summary judgment in favor of Marine Bank on the federal securities claim, holding that if a wrong had occurred it was not connected with the purchase or sale of a "security" as defined by the federal securities acts.⁵²

On appeal, the United States Court of Appeals for the Third Circuit reversed, holding that summary judgment was not appropriate, since a jury could find that either the certificate of deposit or the agreement with the Piccirillos constituted a security.⁵³ In a unanimous opinion, however, the Supreme Court reversed the circuit court, holding that as a matter of law, the certificate of deposit did not constitute a security because it did not involve risk to the investor,⁵⁴ and that the agreement between the Weavers and Piccirillos did not qualify as a security because it was too unique.⁵⁵ In essence, the *Marine Bank* Court added two new requirements — risk and uniqueness — to what constitutes a security under the federal securities laws.⁵⁶ By its holding, the Court has made it more difficult for potential investors to sue under the federal securities acts.⁵⁷ A prospective plaintiff must not only establish that the transaction in question satisfies the classical test, but must also demonstrate that it passes *Marine Bank's* risk and non-uniqueness requirements.⁵⁸

This casenote examines the impact of the Supreme Court's decision in *Marine Bank* on the definition of what constitutes an "investment contract" for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934. In its first section, the casenote traces the historical development of the definition of a security for the purposes of these acts. The second section of this article is composed of four subsections. The first subsection examines the Court's reasoning for determining that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos constituted a security. The second subsection considers the significance and potential impact of the *Marine Bank* holding, and suggests that the Court effectively narrowed the definition of "security" in *Marine Bank* — thereby decreasing the scope of the protection af-

⁴⁹ 637 F.2d at 159.

⁵⁰ *Id.* For the text of the antifraud provision of the Securities Exchange Act of 1934, see *supra* note 5.

⁵¹ *Id.* Pennsylvania Securities Act, PA. STAT. ANN. tit. 70, §§ 1-101 (Purdon Supp. 1980).

⁵² *Weaver v. Marine Bank*, 455 U.S. 551, 554 (1982).

⁵³ *Weaver v. Marine Bank*, 637 F.2d 157, 161-65, (3d Cir. 1980), *rev'd* 455 U.S. 551 (1982).

⁵⁴ *Marine Bank v. Weaver*, 455 U.S. 557-59.

⁵⁵ *Id.* at 559-60.

⁵⁶ For a further discussion of the Court's addition of these two requirements, see *infra* notes 164-203 and accompanying text.

⁵⁷ For an examination of how the addition of the risk and non-uniqueness requirements have made it more difficult for potential investors to sue under the federal securities acts, see *infra* notes 227-35 and accompanying text.

⁵⁸ *Id.*

forded by the federal acts, and increasing the importance of state blue sky laws,⁵⁹ common law and other federal regulatory laws. The third subsection presents a critique of the Court's risk and non-uniqueness requirements. It will be submitted that the risk and non-uniqueness requirements, while effectively narrowing the breadth of the securities acts' protection, were not sufficiently defined by the *Marine Bank* Court, and will require further refinement. The final subsection proposes a modification of *Marine Bank's* risk and non-uniqueness requirements that remedies this problem.

I. THE DEVELOPMENT OF THE DEFINITION OF "SECURITY"

Since the enactment of the federal securities acts, the definition of security has evolved in a number of Supreme Court decisions.⁶⁰ This burden of statutory construction fell to the Court due to the broad all-encompassing language employed by Congress in the acts' definitional sections.⁶¹ The definitional section of the Securities Act of 1933 contains such elastic terms as "unless the context otherwise requires," "investment contract" and "any interest or instrument commonly known as a 'security.'"⁶² Likewise, the definitional section of the Securities Exchange Act of 1934 includes the flexible terms "unless the context otherwise requires," "investment contract" and "any instrument commonly known as a 'security.'"⁶³ The flexibility and ambiguity of these terms have left to the Court the task of developing coherent guidelines for what constitutes a security.

In one of its early security definition cases, *SEC v. C.M. Joiner Corp.*,⁶⁴ the Court focused its definition test on the character a particular instrument is given in commerce.⁶⁵ The Court noted that an instrument is an investment contract, and therefore a security, if it is widely offered or dealt in under terms or courses of dealing which established its "character in commerce" as an investment contract, or as any interest or instrument commonly known as a security.⁶⁶ The defendants in *Joiner* were engaged in a campaign to sell assignments of oil leases.⁶⁷ The sales campaign, conducted through the mail by the use of sales literature, was addressed to nearly 1,000 prospects scattered

⁵⁹ The expression "blue sky," which refers to state security regulations traces its origins to the passage of the 1911 Kansas licensing statute. LOSS, *supra* note 8, at 27 (2d ed. 1961) (quoting Mulvey, *Blue Sky Law*, 36 CAN. L.T. 37, 37 (1916)). The statute's supporters indicated that it was proposed with an eye towards "promoters who 'would sell building lots in the blue sky in fee simple.' " *Id.*

⁶⁰ See *supra* note 9.

⁶¹ For the text of the acts' definitions of security, see *supra* note 7.

⁶² Securities Act of 1933 § 2(1), 15 U.S.C. § 77b (1976). For the text of the act's definition of security, see *supra* note 7.

⁶³ Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78(a)(10) (1976). For the text of the act's definition of security, see *supra* note 7.

⁶⁴ 320 U.S. 344 (1943).

⁶⁵ *Id.* at 351.

⁶⁶ *Id.*

⁶⁷ *Id.* at 345.

throughout the country.⁶⁸ The sales literature assured the prospective buyer that the Joiner Company was currently engaged in and would complete the drilling of a test well to determine the oil-producing possibilities of the offered leaseholds.⁶⁹ The Securities and Exchange Commission filed suit in district court alleging that the sales campaign violated the Securities Act of 1933.⁷⁰ The issue presented in *Joiner*, therefore, was whether the contracts to sell these assignments of oil leases were investment contracts/securities for purposes of the Securities Act of 1933.⁷¹

Applying the "character in commerce" test, the *Joiner* Court concluded that contracts to sell the assignments of oil leases were investment contracts and therefore securities within the meaning of the Securities Act of 1933.⁷² The Court reasoned that the purchasers were not, as a practical matter, paying for naked leasehold rights.⁷³ Rather, they were paying for both a lease and a development project.⁷⁴ The defendant's intention was to sell documents which offered the purchaser a chance, without undue delay or additional cost, of sharing in oil discovery values that might follow from the ongoing exploration for oil.⁷⁵

After *Joiner*, instruments were deemed investment contracts within the federal securities acts' definitions of a security if they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as an investment contract, or as any interest or instrument commonly known as a security.⁷⁶ Three years after *Joiner*, the Supreme Court in *SEC v. W.J. Howey Co.*⁷⁷ modified the "character in commerce" test and articulated what has since been viewed as the classical test for what constitutes a security.⁷⁸ In *Howey*, the named defendant, W.J. Howey Company,⁷⁹ owned large tracts of citrus acreage in Florida.⁸⁰ For several years the company had planted approximately 500 acres annually while offering another 500 acres of the grove to the public to help finance additional development.⁸¹ In conjunction with the sales contract, the company offered prospective purchasers a service contract, informing them that investing in a citrus grove was infeasible

⁶⁸ *Id.* at 346. The leasehold subdivisions offered in the sale never exceeded twenty acres and usually covered two and one-half to five acres at a price of \$5 to \$15 per acre. *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.* at 345.

⁷¹ *Id.* at 348.

⁷² *Id.* at 351.

⁷³ *Id.* at 348.

⁷⁴ *Id.* at 349.

⁷⁵ *Id.* at 348.

⁷⁶ *Id.*

⁷⁷ 328 U.S. 293 (1946).

⁷⁸ See *supra* note 17.

⁷⁹ Howey-in-the-Hills Service, Inc. was an unnamed defendant in the case. *Id.* at 294-95.

⁸⁰ *Id.* at 295.

⁸¹ *Id.* The acres were arranged in units such that each acre consisted of a row of 48 trees. *Id.*

unless service arrangements were made.⁸² Concerning service arrangements, the company stressed the superiority of Howey-in-the-Hills Service, Inc.⁸³ As a result of these sales tactics, eighty-five percent of the acreage sold from 1940 through 1943 was serviced by Howey-in-the-Hills Service, Inc.⁸⁴ Prospective purchasers were encouraged to enter into a ten-year contract with the service company.⁸⁵ Under the contract, the service company would be granted a leasehold interest in the acreage plus complete discretion and authority concerning cultivating, harvesting and marketing the citrus crops.⁸⁶

Since the contracts were not registered pursuant to the federal securities acts, the Securities and Exchange Commission filed suit in district court alleging that W.J. Howey Company and Howey-in-the-Hills Service, Inc. had violated the Securities Act of 1933.⁸⁷ The Commission contended that the sales and service contracts were investment contracts/securities within the meaning of the Act, and therefore had to comply with the statutory mandates.⁸⁸ Both lower courts determined that these sales and service contracts were not investment contracts/securities within the ambit of the 1933 Act.⁸⁹

Rejecting this determination, the Supreme Court drew on the state court's broad interpretation of what constitutes an investment contract within the scope of state blue sky laws,⁹⁰ and established the classical test for defining a security. The *Howey* Court noted that an instrument is an investment contract — and thus a security — if it is a contract, transaction or scheme whereby a person invests his money in a common enterprise⁹¹ and is led to expect profits

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.*

⁸⁵ *Id.* 296.

⁸⁶ *Id.*

⁸⁷ *Id.* at 244.

⁸⁸ *Id.* at 297.

⁸⁹ *Id.* at 297-98.

⁹⁰ *Id.* at 298. The major state case relied upon by the *Howey* Court was *Gopher Tire & Rubber Co.*, 146 Minn. 52, 177 N.W. 937 (1920), in which the state supreme court defined an investment contract as a contract or scheme for "the placing of capital or laying out of money in a way intended to secure income or profit from its employment." *Id.* at 56, 177 N.W. at 938.

⁹¹ There are conflicting authorities on the issue of whether a common enterprise requires the pooling of money of various investors (*i.e.*, "horizontal commonality"), or whether a one-to-one relationship between an investor and an investment manager will suffice (*i.e.*, "vertical commonality"). For a description of these conflicting authorities, see *Troyer v. Karcagi*, 476 F. Supp. 1142, 1147-48, (S.D. N.Y. 1979). The Ninth Circuit has characterized a common enterprise as "one in which the fortunes of the investor are interwoven with, and dependent upon, the efforts and success of those seeking the investment...." *SEC v. Glenn Turner Enters., Inc.*, 474 F.2d 476, 480-81 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973).

⁹² The requirement that the profits be expected solely from the efforts of others has been relaxed to allow the investor some participation. See, *e.g.*, *SEC v. Koscot Interplanetary, Inc.*, 497 F.2d 473, 483 (5th Cir. 1974) (holding pyramid marketing scheme, in which selling efforts of investor were partially responsible for investor's profits, involved a security, indicating that "the critical inquiry is 'whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enter-

solely⁹² from the efforts of a promoter or a third party.⁹³ The *Howey* Court found that the prospective purchasers were attracted by the expectation of substantial profits,⁹⁴ and determined that all the elements of a profit-seeking business venture were present.⁹⁵ The Court concluded that the sales contracts for the units of citrus grove development, coupled with the contracts to service the citrus trees, constituted securities for purposes of the Securities Act of 1933.⁹⁶

After *Howey*, instruments were investment contracts, and therefore securities, if they met *Howey*'s three-pronged test.⁹⁷ First, there must be an investment of money;⁹⁸ second, the investment must be made in a common enterprise,⁹⁹ with the expectation of gaining profits;¹⁰⁰ third, the profits must result solely¹⁰¹ from the efforts of others.¹⁰² The *Howey* test is narrower than the *Joiner* test¹⁰³ because it is less flexible. While the *Joiner* test has one *general* requirement,¹⁰⁴ the *Howey* test has three *specific* requirements. Moreover, the *Howey* test has been even further narrowed by two subsequent major Supreme

prise' ") (quoting SEC v. Glenn Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir. 1973), *cert. denied*, 414 U.S. 821 (1973)); Securities Act Release No. 5347, 38 Fed. Reg. 1735 (1973); reprinted in [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,163 (condominiums offered together with servicing arrangements can constitute securities because "an investment contract may be present in situations where an investor is not wholly inactive") (cited in FitzGibbon, *supra* note 4, at 900 n.24). In *United Hous. Found., Inc. v. Forman*, 421 U.S. 837 (1975), the Supreme Court expressly declined to indicate whether the *Turner* court was correct on this issue. *Id.* at 852 n.16.

State courts have also demonstrated a relaxing of the requirement that the profits be expected *solely* from the efforts of others. See, e.g., *State v. Hawaii Market Center*, 52 Haw. 642, 485 P.2d 105 (1971) ("[i]t is irrelevant to the remedial purposes of the Securities Act that an investor participates in a minor way in the operations of the enterprise. Courts should focus on the quality of the participation. In order to negate the finding of a security the offeree should have practical and actual control over the managerial decisions of the enterprise. For it is control which gives the offeree the opportunity to safeguard his own investment, thus obviating the need for state intervention." *Id.* at 651-52, 485 P.2d at 111).

However, in *Marine Bank v. Weaver*, 445 U.S. 551 (1982), the Court, while deciding the case on other grounds, expressly noted that a contract provision giving the Weavers veto power over future loans gave them a measure of control over the operation of the slaughterhouse not characteristic of a security. *Id.* at 560. For a discussion of the *Howey* test from the perspective of the amount of control exercised, see Newton, *What Is a Security? A Critical Analysis*, 48 Miss. L. J. 167, 190 (1977).

⁹³ SEC v. *Howey*, 328 U.S. 293, 298-99 (1946).

⁹⁴ *Id.*

⁹⁵ *Id.* at 300.

⁹⁶ *Id.* at 299.

⁹⁷ When applying the *Howey* test, courts generally break it down into three prongs. See, e.g., *Troyer v. Karcagi*, 476 F. Supp. 1142, 1147 (S.D.N.Y. 1979).

⁹⁸ *Howey*, 328 U.S. at 299.

⁹⁹ *Id.* The issue of whether a common enterprise requires "horizontal commonality," or whether "vertical commonality" will suffice is largely unresolved. See *supra* note 91.

¹⁰⁰ 328 U.S. at 299.

¹⁰¹ The requirement that the profits result *solely* from the efforts of others has been relaxed on both the federal and state levels. See *supra* note 92.

¹⁰² 328 U.S. at 299.

¹⁰³ For a discussion of the *Joiner* test, see *supra* notes 64-78 and accompanying text.

¹⁰⁴ The general requirement in the *Joiner* test is that the instrument be widely offered or

Court decisions — *United Housing Foundation, Inc. v. Forman*¹⁰⁵ and *International Brotherhood of Teamsters v. Daniel*.¹⁰⁶ In *Forman*, the Court added two requirements to *Howey*'s profits prong.¹⁰⁷ First, the expected profits must result from the *entrepreneurial* or *managerial* efforts of others.¹⁰⁸ Second, the expected profits must not be in the form of a commodity for personal consumption.¹⁰⁹ In *Daniel*, the Court added the requirement that there be a separable element constituting consideration for the security.¹¹⁰

In *Forman*, the tenants of Co-op City,¹¹¹ a publicly financed low-income housing project, were required to purchase shares of stock as a condition of occupying an apartment.¹¹² These shares served the sole purpose of enabling a purchaser to occupy a Co-op City apartment.¹¹³ The shares carried no voting rights, could not be transferred to a nontenant, could not be pledged or encumbered and descended with the apartment only to a surviving spouse.¹¹⁴ A tenant who wished to terminate his occupancy or was forced to move out, was required to offer his shares — at the original purchase price¹¹⁵ — to Riverbay, a corporation organized to own and operate Co-op City.¹¹⁶ If in the "extreme unlikely event" that Riverbay declined to repurchase the stock, the tenant could not sell it for more than the initial purchase price.¹¹⁷ The tenant was further restricted by the fact that the stock could be sold only to a prospective tenant satisfying the statutory income eligibility.¹¹⁸

At the outset, the Court rejected the holding by the United States Court of Appeals for the Second Circuit¹¹⁹ that the shares in question were securities for the purposes of federal securities law simply because they were deemed to be "stock" by the issuers.¹²⁰ Although the definitional sections of the federal

dealt in under terms or courses of dealing which established their character in commerce as an investment contract, or as any interest or instrument commonly known as a security. SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).

¹⁰⁵ 421 U.S. 837 (1975).

¹⁰⁶ 439 U.S. 551 (1979).

¹⁰⁷ 421 U.S. at 855, 858.

¹⁰⁸ *Id.* at 855.

¹⁰⁹ *Id.* at 858.

¹¹⁰ *Daniel*, 439 U.S. at 559-60.

¹¹¹ Fifty-seven residents of Co-op City sued in federal district court on behalf of all 15,372 apartment owners. *Forman v. Community Serv., Inc.*, 366 F. Supp. 1117, 1120 (S.D. N.Y. 1973). The residents alleged violations of the fraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. *Id.* Named as defendants were United Housing Foundation, Community Services, Inc., Riverbay, several individual directors of these organizations, the State of New York, and the State Private Housing Finance Agency. *Id.*

¹¹² 421 U.S. at 842.

¹¹³ *Id.*

¹¹⁴ *Id.*

¹¹⁵ *Id.* at 842. The original purchase price was \$25.00 per share. *Id.* at 841.

¹¹⁶ Riverbay was a corporation organized to own and operate the land and buildings at Co-op City. *Id.*

¹¹⁷ *Id.* at 843.

¹¹⁸ *Id.*

¹¹⁹ 500 F.2d 1246, 1255 (2d Cir. 1974).

¹²⁰ 421 U.S. at 846-47.

securities acts include the word "stock,"¹²¹ the *Forman* Court ruled that such a designation by the issuing party would not be dispositive of the definitional issue.¹²² The Court noted that form should be disregarded for substance,¹²³ and found that the shares in *Forman* were not securities within the meaning of the securities acts because they did not possess the characteristics associated with stock.¹²⁴

The Court then turned to an analysis of the Second Circuit's finding that the stocks in question were securities because they were investment contracts.¹²⁵ Concerning *Howey*'s profit prong, the Second Circuit determined that the stocks had the potential for generating profits from three sources.¹²⁶ First, the circuit court found that the rental reductions resulting from the income produced by the commercial facilities established for the use of tenants at Co-op City were a source of profits.¹²⁷ Second, the appellate court determined that the tax deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage were another source of profits.¹²⁸ Finally, the court found that the savings attributable to the fact that apartments at Co-op City cost substantially less than comparable nonsubsidized housing were a source of profits.¹²⁹

Rejecting the appeals court's reasoning regarding profits, the *Forman* Court distinguished all three asserted sources from its *Howey* requirement. First, the Court found that the rental reductions from the income produced by the commercial facilities established for the tenant's use at Co-op City did not qualify as profits under *Howey*.¹³⁰ The Court indicated that the potential income from these commercial facilities was far too speculative and insubstantial to bring the entire transaction within the securities acts.¹³¹ The Court concluded that the distinguishing factor in the *Forman* transaction was that the profits in *Forman* were in the form of a commodity for personal consumption.¹³² Second, the Supreme Court determined that the deductions for the portion of the monthly rental charges allocable to interest payments on the mortgage did not qualify as profits within the meaning of *Howey*.¹³³ The Court reasoned that these benefits were available to all homeowners who were paying interest on their mortgage, and, as such, were not unique to this situation.¹³⁴ Finally, the

¹²¹ For text of statutory definitions, see *supra* note 7.

¹²² 421 U.S. at 848.

¹²³ *Id.* (citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967)).

¹²⁴ *Id.* at 851. For the unique characteristics of the shares, see *supra* notes 111-18 and accompanying text.

¹²⁵ *Id.* at 851. For the Second Circuit's finding, see 500 F.2d 1246, 1255 (2d Cir. 1974).

¹²⁶ 500 F.2d 1246, 1254 (2d Cir. 1974).

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ 421 U.S. at 855-56.

¹³¹ *Id.* at 856.

¹³² *Id.* at 858.

¹³³ *Id.* at 855.

¹³⁴ *Id.*

Supreme Court found that the savings resulting from the substantially lower cost of apartments at Co-op City were not profits within the meaning of *Howey*.¹³⁵ The Court based its finding on the fact that the low rent was derived from the substantial financial subsidies provided by New York State.¹³⁶ Consequently, the profit did not result from the *entrepreneurial* or *managerial* efforts of others.¹³⁷ The Court concluded that the shares of stock were "a recoverable deposit on an apartment,"¹³⁸ and that selling them did not constitute a sale of securities for purposes of the federal securities laws.¹³⁹

*International Brotherhood of Teamsters v. Daniel*¹⁴⁰ narrowed the *Howey* test by adding the requirement that the security be supported by a separable element of consideration.¹⁴¹ The issue in *Daniel* was whether an employee's interest in a compulsory pension plan constituted a security within the meaning of the security acts.¹⁴² Under the terms of the plan, the employees paid nothing into the pension fund, exercised no choice regarding participation in the plan and could not demand that the employer's contribution be paid directly to the employee in lieu of pension eligibility.¹⁴³ Eligible employees¹⁴⁴ received pension benefits upon retirement in a fixed amount determined by a formula.¹⁴⁵ The employee bringing suit in *Daniel* contended that by allowing his employer to pay money into the fund and by laboring for the employer in return for these payments, he had made the type of investment that satisfies *Howey*.¹⁴⁶

The *Daniel* Court rejected the employee's contention, reasoning that the purported investment in the pension plan was a relatively insignificant part of an employer's total and indivisible compensation package.¹⁴⁷ The Court stressed that the typical employee receives a compensation package that is "substantially devoid of aspects resembling a security."¹⁴⁸ The Court noted that an employee's decision to accept and retain employment covered by a pension plan may have only an "attenuated relationship, if any, to perceived investment possibilities of a future pension."¹⁴⁹ In essence, the employer's in-

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Id.* at 842.

¹³⁹ *Id.* at 859-60.

¹⁴⁰ 439 U.S. 551 (1979).

¹⁴¹ *Id.* at 560.

¹⁴² *Id.* at 553.

¹⁴³ *Id.*

¹⁴⁴ Eligibility required twenty years of continuous service. *Id.* at 554.

¹⁴⁵ For a more exhaustive description of the plan, see Kelly, *Securities Regulation of Retirement Plans After Daniel*, 10 LOY. U. CHI. L.J. 631, 635-40 (1979).

¹⁴⁶ The *Daniel* Court noted that the employee contended that the investment was of the type the securities acts were intended to regulate. 439 U.S. at 559.

¹⁴⁷ *Id.* at 560.

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

terest in the pension plan failed *Howey's* investment-of-money requirement because it was impossible to distinguish a separable element constituting consideration for the alleged security.¹⁵⁰

The *Daniel* Court also noted that the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) "undercut" the contention that an employee's interest in the pension plan was a security within the meaning of the securities acts.¹⁵¹ The Court grounded this comment on its finding that whatever benefits employees might derive from the effect of the securities acts were provided in more definite form through ERISA.¹⁵² The enactment of ERISA, however, was not dispositive of the issue of whether the employee's interest in the compulsory pension constituted a security.¹⁵³ The Court indicated that ERISA would have "put the matter to rest" if further evidence were needed to demonstrate that the pension plan in question was not a security for purposes of the federal securities acts.¹⁵⁴ Thus, the Court's observations concerning the benefits derived from ERISA were dicta.¹⁵⁵

In the interim between *Daniel* and *Marine Bank v. Weaver*, therefore, the refined *Howey* test included three distinct requirements. First, an individual must have invested money in a common enterprise¹⁵⁶ such that there was a separable element constituting consideration for the security.¹⁵⁷ Second, an individual investor must have been led to expect profits¹⁵⁸ that did not take the form of a commodity for personal consumption.¹⁵⁹ Third, the expected profits must have been derived solely¹⁶⁰ from the entrepreneurial or managerial efforts of

¹⁵⁰ *Id.* The *Daniel* Court also considered whether the employee's interest in the pension plan met the profits requirement of *Howey*. *Id.* at 561-62. The Court conceded that the pension plan depended to some extent upon earnings from its assets. *Id.* The Court, however, distinguished the pension fund in question by the fact that a much larger portion of its income was derived from employer contributions. *Id.* at 562. The Court concluded that this source of income was not dependent on the efforts of the pension plan's managers. *Id.* Consequently, the Court found that *Howey's* profit requirement was not met. *Id.* The Court supported this finding with its observation that the principle barrier to an individual employee realizing pension benefits was not the financial health of the fund. *Id.* Rather, it was the employee's ability to meet the fund's eligibility requirements. *Id.* The Court noted that even assuming *arguendo* that it was proper to characterize the benefits as a profit, this profit would depend primarily on the employee's efforts to meet the vesting requirements, rather than the fund's investment success. *Id.*

¹⁵¹ *Id.* at 569-70.

¹⁵² *Id.* at 570.

¹⁵³ *Id.* at 569-70.

¹⁵⁴ *Id.* at 569.

¹⁵⁵ In *Marine Bank v. Weaver*, however, the rationale underlying these observations was dispositive of the Weavers' argument that their certificate of deposit constituted a security. 455 U.S. 551, 557-59 (1982). See *infra* notes 164-82 and accompanying text for a further examination of the role this rationale played in *Marine Bank*.

¹⁵⁶ SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). See *supra* note 91 on issue of whether the common enterprise requirement requires "horizontal commonality," or whether "vertical commonality" fulfills the common enterprise requirement.

¹⁵⁷ International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559-60 (1979).

¹⁵⁸ SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

¹⁵⁹ United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975).

¹⁶⁰ For a discussion of how the requirement that the profits result solely from the efforts

others.¹⁶¹ Additionally, the *Daniel* dicta indicates that the existence of federal legislation other than the securities acts may undercut the contention that the instrument in question is a security.¹⁶² This may be the case if an individual derived from such legislation all the benefits provided by the securities acts.¹⁶³

II. THE *HOWEY* TEST AFTER *MARINE BANK V. WEAVER*

This section of the casenote analyzes the importance of the Supreme Court's decision in *Marine Bank* in four subsections. First, the Supreme Court's reasoning for finding that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos constituted a security is examined. The examination demonstrates that the Court added two requirements to *Howey* — risk and uniqueness. The second subsection examines the significance of *Marine Bank*, and suggests that by adding the requirements of risk and non-uniqueness, *Marine Bank* narrows what is a security for purposes of the federal securities acts. This suggestion is evidenced by demonstrating that both the certificate of deposit and the agreement between the Weavers and the Piccirillos would have been securities under the *Howey* test. The impact of *Marine Bank* on security law is also examined in this subsection. It is suggested that in the wake of *Marine Bank*, state blue sky laws, common law and federal regulations that regulate securities have gained increased importance in securities law. The next subsection critiques *Marine Bank*'s risk and non-uniqueness requirements. The critique demonstrates that while *Marine Bank*'s risk and non-uniqueness requirements provide some guidance in determining what constitutes a security, they are problematic because the Court failed to make sufficiently clear how to apply them. The final section, therefore, proposes a modification that remedies these problems of *Marine Bank*'s risk and non-uniqueness requirements.

A. *The Supreme Court's Reasoning in Marine Bank v. Weaver*

In *Marine Bank*, the Supreme Court ruled that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos constituted a security for purposes of the Securities Exchange Act of 1934.¹⁶⁴ The Court, in reaching this decision, recognized the broad scope encompassed by the definition of a security for purposes of federal security laws.¹⁶⁵ The Court observed, however, that the statute excluded instruments "if the context otherwise re-

of others has been relaxed, see *supra* note 92.

¹⁶¹ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 855 (1975) (efforts must be *entrepreneurial* or *managerial*); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (the profits must result from efforts of others).

¹⁶² *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 569-70 (1979).

¹⁶³ *Id.* at 570.

¹⁶⁴ *Marine Bank v. Weaver*, 455 U.S. 551, 557-59 (1982). The Weavers alleged that *Marine Bank* violated § 10b of the Securities Exchange Act of 1934. *Id.* at 554.

¹⁶⁵ *Id.* at 555.

quires. . . ."¹⁶⁶ In examining the context surrounding the two instruments in *Marine Bank*, the Court concluded that circumstances existed which distinguished the instruments from those commonly considered securities.¹⁶⁷ In distinguishing the certificate of deposit and agreement between the Weavers and the Piccirillos in *Marine Bank* from securities within the meaning of the federal securities law, the Court modified the *Howey* test by further defining the proper context for a security.

The *Marine Bank* Court considered the two instruments separately.¹⁶⁸ First, the Court determined that the certificate of deposit was not a security because it did not involve risk to the investor.¹⁶⁹ In analyzing the certificate of

¹⁶⁶ *Id.* at 556.

¹⁶⁷ *Id.* at 557-60.

¹⁶⁸ *Id.* at 556-60.

¹⁶⁹ *Id.* at 557-59.

Interestingly, *Marine Bank v. Weaver* constituted the Court's first treatment of the security status of notes. *Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 846 (N.D. Cal. 1982); Sonnenschein, *Federal Securities Laws Coverage of Note Transactions; Antifraud Provisions*, 35 BUS. LAW. 1567, 1569 (1980). While a thorough examination of note securities is beyond the scope of this article, it should be pointed out that prior to *Marine Bank*, at least four approaches were utilized by the courts in resolving the question of when a note becomes a security. One approach was the *Howey* test. See *SEC v. First Am. Bank and Trust Co.*, 421 F.2d 673, 678 (8th Cir. 1973); *MacKethan v. Peat, Marwick, Mitchell & Co.*, 439 F. Supp. 1090, 1094 & n.9 (E.D. Va. 1977). This approach has been criticized on the grounds that notes cannot pass the *Howey* test because they bear fixed rates of interest. *Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 846-47 (N.D. Cal. 1982). This criticism is based on the Supreme Court's definition of profits under *Howey* as either "capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of the investors' funds. . . ." *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 852 (1975). Another approach is the "commercial-investment" test. See *McClure v. First Nat'l Bank*, 497 F.2d 490, 493 (5th Cir. 1974). This approach distinguishes between investment and commercial transactions in determining whether a note is a security. Comment, *When is a Note a Security?*, 18 SANTA CLARA L. REV. 757, 763 (1978). The "commercial-investment" test involves a case-by-case comparison of the note with opposing archetypes — common stock which is plainly a security, and consumer loans and bank loans to finance the purchase of an automobile which are not securities. See, e.g., *C.N.S. Enter., Inc. v. G. & G. Enter., Inc.*, 508 F.2d 1354, 1359 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975). This approach has been criticized for providing "little to no" guidance. *Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 847 (N.D. Cal. 1982).

A third approach is the "risk capital" approach. See *Amfac Mortgage Corp. v. Arizona Mall, Inc.*, 583 F.2d 426 (9th Cir. 1978); *Great Western Bank & Trust Co. v. Kotz*, 532 F.2d 1252 (9th Cir. 1976); *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 361 P.2d 906, 13 Cal. Rptr. 189 (1961). Under this approach, the inquiry is whether there has been a contribution of "risk capital" — which is to be distinguished from a "risky loan" — that is subject to the entrepreneurial efforts of the party receiving the contribution. *Great Western Bank & Trust Co. v. Kotz*, 532 F.2d 1252, 1257 (9th Cir. 1976). This approach has been criticized as being too open-ended. *Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 849 (N.D. Cal. 1982). This approach has also been criticized as finding a security where there is risk capital even though the provider of capital may not be seeking profits or investing in a common enterprise as required by *Howey*. *Deacon & Prendergast, Defining a "Security" After the Forman Decision*, 11 PACIFIC L.J. 213, 222 (1980). The final approach is that used by the Second Circuit. *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126 (2d Cir. 1976). Under this approach, the Second Circuit interprets the language of the securities acts' definitional sections literally unless the context otherwise requires. *Id.* at 1137. Under this test, the burden of demonstrating that the context otherwise requires is placed upon the party asserting that: (1) a note of more than nine months maturi-

deposit, the Court distinguished it from other long-term debt obligations on two grounds. First, the Court observed that the certificate of deposit was issued by a federally regulated bank.¹⁷⁰ As such, the certificate of deposit was issued by an institution subject to comprehensive federal banking regulations, and was protected by the reserve, reporting and inspection requirements of the federal banking laws.¹⁷¹ Therefore, the certificate of deposit in *Marine Bank*, unlike many other long-term debt obligations, was protected by federal regulations other than the securities acts.¹⁷²

The Court in *Marine Bank* also distinguished the certificate of deposit from other long-term debt obligations on the grounds that the certificate of deposit was insured by the Federal Deposit Insurance Corporation (F.D.I.C.).¹⁷³ The Court found this significant in light of its observation that nearly all depositors in failing F.D.I.C. insured banks have received payment in full.¹⁷⁴ Based on this observation, the Court determined that the certificate of deposit in *Marine Bank* was distinguishable from other long-term debt obligations because "the purchaser of a certificate of deposit is virtually guaranteed payment in-full, whereas the holder of an ordinary long-term debt obligation assumes the risk of the borrower's insolvency."¹⁷⁵ The Court, therefore, based its conclusion that the certificate of deposit in *Marine Bank* was not a security on its finding that the federal banking regulations and the Federal Deposit Insurance Corporation's insurance protection eliminated the risk to the investor, and thereby obviated the need for the federal securities laws.¹⁷⁶

Marine Bank marks the first time that the Court has elevated the risk requirement to the level of an independent criterion for determining whether a given instrument qualifies as a security for purposes of federal securities law. The rationale underlying the risk requirement of *Marine Bank*, however, did appear earlier in *International Brotherhood of Teamsters v. Daniel*.¹⁷⁷ In *Daniel*, the Court noted that the Employee Retirement Income Security Act of 1974 (ERISA) undercut the argument that the pension plan in question constituted

ty is not within the Securities Exchange Act of 1934; (2) that a note with a maturity of nine months or less is within the act or; (3) that any note is not within the antifraud provisions of the Securities Exchange Act of 1933. *Id.* at 1137-38. For the text of the securities acts' definition of security, see *supra* note 7.

The *Marine Bank* Court did not explicitly adopt any of these approaches. It may be argued, however, that the decision supports the "risk capital" test because the Court eliminated the certificate of deposit on the grounds of risk. See *supra* notes 168-82. This argument, however, is undermined by the fact that despite not explicitly addressing the *Howey* test in the context of the certificate of deposit, the *Marine Bank* Court demonstrated no inclination to relax *Howey*'s profit-seeking and common enterprise requirements.

¹⁷⁰ *Marine Bank v. Weaver*, 455 U.S. 551, 558 (1982).

¹⁷¹ *Id.*

¹⁷² *Id.*

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* (emphasis added).

¹⁷⁶ *Id.* at 558-59.

¹⁷⁷ 439 U.S. 551, 569-70 (1979). For the appearance of the rationale underlying *Marine Bank*'s risk requirement, see *supra* notes 151-55 and accompanying text.

a security for the purposes of the federal securities laws.¹⁷⁸ The *Daniel* Court reasoned that any protection which the employee might be afforded through the security acts was provided through ERISA.¹⁷⁹ Despite articulating the rationale for the "at risk" standard, however, the Court in *Daniel* grounded its holding on its findings that there was no separable element constituting consideration for the supposed security,¹⁸⁰ and that a substantial portion of the expected profits did not come from the managerial efforts of others.¹⁸¹ In contrast to *Daniel*, *Marine Bank* elevated the "at risk" requirement to be independently dispositive of whether an instrument qualifies as a security for federal securities law.¹⁸²

The *Marine Bank* Court next considered the agreement between the Weavers and the Piccirillos.¹⁸³ The Court determined that this agreement was not a security for purposes of federal securities law because it was too unique.¹⁸⁴ The Court noted that this uniqueness indicated that the agreement was not designed to be traded publicly.¹⁸⁵ The Court supported its determination that the agreement was too unique to be a security with three observations. First, the agreement between the Weavers and the Piccirillos — unlike instruments that qualified for federal securities law — did not involve offers to a number of potential investors.¹⁸⁶ The Court highlighted this observation by noting that the Piccirillos did not distribute a prospectus to either the Weavers or any other potential investors.¹⁸⁷ Second, the Court observed that the provision that the Weavers could use the barn and pastures at the discretion of the Piccirillos rendered the agreement unique as compared with securities deemed within the meaning of the federal securities acts.¹⁸⁸ Finally, the Court noted that the Weavers' veto power over future loans gave them a measure of control over the slaughterhouse uncharacteristic of a security.¹⁸⁹ Consequently, the Court determined that the combination of these characteristics rendered the agreement between the Weavers and the Piccirillos too unique to constitute a security within the meaning of the federal securities acts.¹⁹⁰ The Court distinguished the instruments in *C.M. Joiner Leasing* and *Howey* from the agreement between the Weavers and the Piccirillos by noting that they "had equivalent values to most persons and could have been traded publicly."¹⁹¹ After *Marine Bank*,

¹⁷⁸ 439 U.S. at 569-70.

¹⁷⁹ *Id.* at 570.

¹⁸⁰ *Id.* at 560.

¹⁸¹ *Id.* at 561-62.

¹⁸² *Marine Bank v. Weaver*, 455 U.S. 551, 558-59 (1982).

¹⁸³ *Id.* at 559-60.

¹⁸⁴ *Id.*

¹⁸⁵ *Id.* at 560.

¹⁸⁶ *Id.* at 559-60.

¹⁸⁷ *Id.* at 560.

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*

¹⁹⁰ *Id.*

¹⁹¹ *Id.* See *supra* notes 64-78 and accompanying text for a discussion of the instrument in *Joiner*, and see *supra* notes 77-106 and accompanying text for a discussion of the instrument in

therefore, if an instrument is found to be too unique, it may not be deemed a security within the meaning of federal securities law.¹⁹²

In essence, in determining that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos in *Marine Bank* constituted a security for purposes of the federal securities acts, the *Marine Bank* Court added two requirements to the *Howey* test. First, there may not be any federal regulations or insurance schemes that eliminate the risk involved in the investment.¹⁹³ Second, the instruments in question may not be too unique.¹⁹⁴ After *Marine Bank*, therefore, the *Howey* test for finding a "security" has acquired further refinements, requiring five, rather than the previous three,¹⁹⁵ separate inquiries. First, an investor must invest money in a common enterprise¹⁹⁶ such that the security is supported by a separable element constituting consideration.¹⁹⁷ Second, the investor must expect profits¹⁹⁸ that cannot be in the form of a commodity for personal consumption.¹⁹⁹ Third, the profits must be gained solely²⁰⁰ through the entrepreneurial or managerial efforts of others.²⁰¹ Fourth, there cannot be any federal regulations or insurance schemes that eliminate the risk to the investor.²⁰² Finally, the security may be disqualified if it is too unique.²⁰³ Given the inclusion of the fourth and fifth inquiries as distinct criteria, *Marine Bank* is likely to bring about modifications in the application of the securities laws. This casenote now addresses this concern.

B. *The Significance and Impact of Marine Bank v. Weaver*

In *Marine Bank*, the Court narrowed what constitutes a security by adding the requirements of risk and non-uniqueness to the *Howey* test. This narrowing may be illustrated by demonstrating that both the certificate of deposit and the agreement between the Weavers and the Piccirillos in *Marine Bank* would have survived scrutiny under the pre-*Marine Bank* *Howey* test. In the wake of the narrower protection afforded by the securities acts, it is suggested that state blue sky laws, common law and federal regulations that regulate particular financial instruments have acquired greater significance.

Howey.

¹⁹² 455 U.S. at 560.

¹⁹³ *Id.* at 557-59.

¹⁹⁴ *Id.* at 559-60.

¹⁹⁵ For a further discussion of these three inquiries, see *supra* notes 79-163 and accompanying text.

¹⁹⁶ SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). See *supra* note 91 for a further discussion of the common enterprise requirement.

¹⁹⁷ International Bhd. of Teamsters v. Daniel, 439 U.S. 551, 559-60 (1979).

¹⁹⁸ SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

¹⁹⁹ United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975).

²⁰⁰ For an examination of the trend to relax the requirement that the profits result solely from the efforts of others, see *supra* note 92.

²⁰¹ *Forman*, 421 U.S. 837, 855 (1975) (efforts must be *entrepreneurial* or *managerial*); SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946) (profits must be gained through efforts of others).

²⁰² *Marine Bank v. Weaver*, 455 U.S. 551, 557-59 (1982).

²⁰³ *Id.* at 559-60.

Prior to *Marine Bank*, the *Howey* test consisted of three elements.²⁰⁴ The first prong of the pre-*Marine Bank Howey* test requires that the investor invest his money in a common enterprise such that there is a separable element constituting consideration for the instrument.²⁰⁵ The certificate of deposit in *Marine Bank* — which had a face value of \$50,000, paid 7½ % interest, and was issued by *Marine Bank* to the Weavers²⁰⁶ — survives scrutiny under the first prong of this test. The \$50,000 invested by the Weavers in a certificate of deposit issued by *Marine Bank* constitutes an investment of money in a common enterprise. The \$50,000 investment by the Weavers also constitutes a separable element of consideration for the certificate of deposit. Therefore, since the Weavers invested \$50,000 in a common enterprise, and the \$50,000 constituted a separable element of consideration for the certificate of deposit, the certificate of deposit satisfies the first requirement of the pre-*Marine Bank Howey* test.

The second prong of the pre-*Marine Bank Howey* test is also met by the certificate of deposit in *Marine Bank*. The second prong requires that the investor be led to expect profits that may not take the form of a commodity for personal consumption.²⁰⁷ The Weavers were led to expect profits from their investment in the certificate of deposit because the certificate of deposit paid 7½ % interest.²⁰⁸ Furthermore, the interest payments took the form of cash — not a commodity for personal consumption. Therefore, since the Weavers were led to expect profits in the form of 7½ % interest on the \$50,000 certificate of deposit, the \$50,000 certificate of deposit falls within the second requirement of the pre-*Marine Bank Howey* test. The certificate of deposit also satisfies the third element of the pre-*Marine Bank Howey* test — that the expected profits result solely through the entrepreneurial or managerial efforts of others.²⁰⁹ The certificate of deposit's interest payment was to be gained solely through the entrepreneurial and managerial efforts of *Marine Bank*. The certificate of deposit, therefore, meets the third requirement of the pre-*Marine Bank Howey* test.

²⁰⁴ See *supra* notes 156-63 and accompanying text.

²⁰⁵ *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-60 (1979) (investment must be made such that there is a separable element of consideration); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (investor must invest in a common enterprise).

²⁰⁶ *Marine Bank v. Weaver*, 455 U.S. 551, 552, 553, n.1 (1982).

²⁰⁷ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 858 (1975) (profits cannot be in form of commodity for personal consumption); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (investor must be led to expect profits).

²⁰⁸ This conclusion is supported by at least two recorded decisions. See *SEC v. First American Bank and Trust Co.*, 421 F.2d 673, 679 (8th Cir. 1973) and *MacKethan v. Peat, Marwick, Mitchell & Co.*, 439 F. Supp. 1090, 1094 & n.9 (E.D. Va. 1977). There are, however, decisions to be contrary. See *Canadian Imperial Bank of Commerce v. Fingland*, 615 F.2d 465, 468-70 (7th Cir. 1980); *Hamblett v. Board of Sav. & Loan Ass'n*, 472 F. Supp. 158, 165 (N.D. Miss. 1979) and *Hendrickson v. Buchbinder*, 465 F. Supp. 1250, 1258 (S.D. Fla. 1979) (all reasoning that a fixed interest rate does not satisfy *Howey's* profit requirement because it is not based on the enterprise's profitability).

²⁰⁹ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 855 (1975) (profits must result from entrepreneurial or managerial efforts of others); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299

The certificate of deposit in *Marine Bank*, however, seems to run afoul of the Supreme Court's suggestion in *International Brotherhood of Teamsters v. Daniel*²¹⁰ concerning the existence of federal legislation that regulates the instrument. In *Daniel*, the Supreme Court suggested that the existence of federal legislation that regulates the instrument in question would undercut the contention that the instrument is a security if that legislation provided the investor with all the benefits provided by the securities acts.²¹¹ The *Daniel* Court's suggestion is pertinent in *Marine Bank* because *Marine Bank* is a federally regulated bank.²¹² Consequently, *Marine Bank*'s deposits are protected by the reserve, reporting and inspection requirements of the federal banking laws.²¹³ The Court's suggestion in *Daniel* concerning the existence of federal legislation, however, is not fatal to the certificate of deposit, because the suggestion is dicta.²¹⁴

Thus, since the certificate of deposit passes the first three requirements of the pre-*Marine Bank Howey* test and the dicta in *Daniel* is not fatal to the result, the certificate of deposit would have constituted a security if the *Marine Bank* Court had not expanded upon the "at risk" requirement.

Concerning the contractual agreement between the Weavers and the Piccirillos, the Third Circuit determined that a jury could find that it passed the pre-*Marine Bank Howey* test.²¹⁵ Applying the pre-*Marine Bank Howey* test, the agreement between the Weavers and the Piccirillos survives scrutiny under the first prong, which requires a common enterprise investment and separable consideration.²¹⁶ The Weavers made an investment in a common enterprise by depositing \$50,000 in *Marine Bank* to secure the \$65,000 loan to Columbus Packing. The pledge of the certificate of deposit as security constituted a separable element of consideration for the agreement. The first prong of the pre-*Marine Bank Howey* test, therefore, is satisfied by the agreement. The agreement also satisfies the second prong of the earlier test, which requires that investors expect profits that are not in the form of a commodity for personal consumption.²¹⁷ By the terms of the agreement, the Weavers were led to expect

(1946) (profits must result from efforts of others).

²¹⁰ *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 569-70 (1979).

²¹¹ *Id.*

²¹² *Marine Bank v. Weaver*, 455 U.S. 551, 558 (1982).

²¹³ *Id.*

²¹⁴ *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 569-70 (1979). For further discussion of this dicta, see *supra* notes 151-55 and accompanying text.

²¹⁵ *Weaver v. Marine Bank*, 637 F.2d 157, 162-63 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982). The Third Circuit did not explicitly state that a jury could find that the agreement between the Weavers and the Piccirillos passed the *Howey* test. *Id.* Rather, the Third Circuit cited *Howey*, noted its requirements, and determined that a jury could find that the agreement between the Weavers and the Piccirillos met these requirements. *Id.*

²¹⁶ *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-60 (1979) (investment must be made such that there is separable element of consideration for the instrument); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946) (investor must invest money in a common enterprise).

²¹⁷ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 858 (1975) (profits cannot be

profits in three forms: one hundred dollars per month, fifty percent of Columbus Packing's "adjusted net profits" and the use of the barn and pastures of the slaughterhouse at the Piccirillos' discretion.²¹⁸ Neither the one hundred dollars per month nor the fifty percent of Columbus Packing's "adjusted net profits" are commodities for personal consumption. Further, while the use of the barn and pastures of the slaughterhouse may be in the form of a commodity for personal consumption, their use seems to be an incidental purpose of the transaction.²¹⁹ A reasonable fact finder, therefore, could determine that the Weavers' \$50,000 investment was primarily motivated by a desire to earn one hundred dollars per month and fifty percent of Columbus Packing's "adjusted net profits."²²⁰ The dispositive personal consumption element of housing in *Forman*, therefore, is distinguishable because it was the primary purpose of the transaction.²²¹ Consequently, the second requirement of the pre-*Marine Bank* *Howey* test is met.

Finally, the agreement between the Weavers and the Piccirillos meets the third pre-*Marine Bank* *Howey* requirement that the profits result solely from the entrepreneurial or managerial efforts of others.²²² This prong is satisfied by the agreement in *Marine Bank* because both the one hundred dollars per month and the fifty percent of Columbus Packing's "adjusted net profits" were to be gained through the entrepreneurial and managerial efforts of the Piccirillos.²²³ Therefore, since the agreement between the Weavers and the Piccirillos sur-

in form of commodity for personal consumption); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (investor must be led to expect profits).

²¹⁸ *Weaver v. Marine Bank*, 637 F.2d 157, 159 (3d Cir. 1980), *rev'd*, 455 U.S. 551 (1982).

²¹⁹ The Circuit Court indicated the importance of this primary incidental distinction by stating that "[i]f a fact finder were to determine that use of the barn and pasture was a primary rather than an incidental purpose of the transaction, it might well decide in favor of *Marine Bank*." *Weaver v. Marine Bank*, 637 F.2d 157, 162, *rev'd*, 455 U.S. 551 (1982).

²²⁰ *Weaver v. Marine Bank*, 637 F.2d 157, 162, *rev'd*, 455 U.S. 551 (1982).

²²¹ *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 858 (1975).

²²² *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 855 (1975) (profits must result from *entrepreneurial or managerial* efforts of others); *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946) (profits must result from efforts of others).

²²³ Another issue concerns whether the *Howey* requirement that the profits result *solely* from the efforts of others has been violated. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946). There has, however, been a trend towards relaxing this requirement. *See supra* note 92. In *Marine Bank*, the issue is whether the Weavers' veto power over future loans allowed them a degree of participation in the slaughterhouse such that the requirement that the profits be expected *solely* through the efforts of others was not met. Based on its findings that "there [was] no evidence whatsoever in the record that the Weavers wanted to use or develop the Columbus Packing slaughterhouse themselves," and that it did not appear that the Weavers "were issuing their obligations to purchase a business they intended to manage," the Third Circuit distinguished the efforts of the Weavers from those which result in an instrument being disqualified for not deriving profits *solely* from the efforts of others. *Weaver v. Marine Bank*, 637 F.2d 157, 162 & n.5 (1980), *rev'd on other grounds*, 455 U.S. 551 (1982). The appeals court's analysis seems correct because the degree of control conferred on the Weavers by their veto power over future loans to the slaughterhouse did not rise to a level such that they could safeguard their own investment through involvement in the slaughterhouse's management.

vives scrutiny under the pre-*Marine Bank Howey* test,²²⁴ it would have been a security if the *Marine Bank* Court had not promulgated the uniqueness requirement.

Despite this analysis suggesting that both the certificate of deposit and the agreement between the Weavers and the Piccirillos were securities under the pre-*Marine Bank Howey* test, the Supreme Court determined in *Marine Bank* that neither instrument constituted a security for purposes of the Securities Exchange Act of 1934.²²⁵ In reaching its determination that neither instrument was a security, the Court added the requirements of "risk" and "non-uniqueness" to the *Howey* test.²²⁶ By adding these requirements to the *Howey* test, therefore, the Court in *Marine Bank* effectively narrowed the class of instruments qualifying as securities under the federal securities acts.

By adding the two new requirements to the *Howey* test, the *Marine Bank* Court has made it more difficult for potential investors to sue in the federal courts under the federal securities acts. A prospective plaintiff must now not only establish that the transaction in question satisfies the three prongs of *Howey*, but must also demonstrate that it passes the risk and non-uniqueness tests laid down in *Marine Bank*. Indeed, the facts of *Marine Bank* provide a clear example of this difficulty. Since the two instruments involved in *Marine Bank* may well have survived scrutiny under the *Howey* test,²²⁷ by adding the risk and non-uniqueness requirements, the Court determined that the Weavers could not claim the securities acts' protection.²²⁸

As a result of this higher barrier to invoking protection under the federal securities acts, plaintiffs will be forced to pursue their claims in the state courts under common law and state blue sky laws.²²⁹ Consequently, state blue sky laws and common law protections arguably have acquired far greater importance in the securities regulation field. Due to the elevated status accorded state law as an indirect result of the *Marine Bank* decision, practitioners must now consider more seriously state law claims, in addition to federal remedies where available when litigating a matter involving a borderline instrument.

From a plaintiff's perspective, there are several procedural disadvantages to litigating security claims in state courts. An obvious procedural disadvantage is the elimination of the plaintiff's previous option of bringing a securities claim under federal or state law.²³⁰ If the plaintiff had such an option, she could choose to bring suit under the law which provided the most protection. Moreover, litigants bringing claims actionable only under state law must con-

²²⁴ The uniqueness requirement was not a prong of the pre-*Marine Bank Howey* test. See *supra* notes 156-63 and accompanying text.

²²⁵ *Marine Bank v. Weaver*, 455 U.S. 559-60 (1982).

²²⁶ For a further discussion of the addition of these requirements, see *supra* notes 164-203 and accompanying text.

²²⁷ See *supra* notes 204-24 and accompanying text.

²²⁸ *Marine Bank v. Weaver*, 455 U.S. 551, 560-61 (1982).

²²⁹ "Blue Sky" is an expression used for state securities laws. See *supra* note 59.

²³⁰ Even if a plaintiff is in federal court pursuant to diversity jurisdiction, the court must apply state law. *Erie R.R. v. Tompkins*, 304 U.S. 64, 71-80 (1938).

sider whether the state court can exercise jurisdiction over the defendant. To demonstrate that the state court has jurisdiction, the plaintiff must establish that the defendant is within reach of the state's jurisdictional statute.²³¹ While the federal securities acts extend jurisdiction as far as allowed by the due process clause of the United States Constitution,²³² state jurisdictional statutes do not always extend their jurisdiction as far.²³³ State courts' jurisdictional requirements, therefore, are often more stringent than federal courts' jurisdictional requirements.²³⁴ Another procedural disadvantage confronting a plaintiff limited to the state court systems is the conflict of laws problem of which state law governs the security.²³⁵ The federal securities acts, on the other hand, provide certainty because they are uniform. By narrowing the definition of security, therefore, *Marine Bank* disadvantages plaintiffs by barring them from the procedural advantages of the federal securities acts.

In addition to increasing the importance of state securities laws, with the consequent disadvantages to litigants, the *Marine Bank* Court has altered the balance among federal regulatory statutes. By adding the requirements of risk to the *Howey* test, the Court in *Marine Bank* increased the importance of federal legislation other than the securities acts and insurance schemes. The Court disqualified the certificate of deposit in *Marine Bank* on the grounds that federal banking regulations and Federal Deposit Insurance Corporation insurance coverage obviated the need for protection under the securities acts by sufficiently protecting investors from risk. In doing so, the Court demonstrated that if there is federal legislation and/or an insurance scheme sufficiently protective of investments that it eliminates investor risk, the investment in question will not qualify as a security for purposes of the federal security acts. Consequently, after *Marine Bank*, a court faced with novel instruments must consider the following to determine whether that instrument is within the purview of federal securities law. First, the court must determine whether the instrument is regulated by federal legislation other than the securities acts. Next, it must determine whether the instrument is covered by an insurance scheme. If the court

²³¹ See generally 4 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE: Civil § 1068 (1969 & Supp. 1982).

²³² For the broad jurisdictional provision of the Securities Act of 1933, see the Securities Act of 1933, § 22, 15 U.S.C. § 77v (1976). For the equally broad jurisdictional provision of the Securities Exchange Act of 1934, see the Securities Exchange Act of 1934, § 27, 15 U.S.C. § 77aa (1976). The jurisdictional provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 have been interpreted to extend their reach as far as the due process clause of the fifth amendment will allow. See *Bersch v. Drexel Firestone, Inc.*, 389 F. Supp. 446, 459-60 (S.D. N.Y. 1974), *aff'd in part, rev'd in part on other grounds*, 519 F.2d 974 (2d Cir. 1975) *cert. denied*, 423 U.S. 1018 (1975).

²³³ See generally 4 WRIGHT & MILLER, FEDERAL PRACTICE AND PROCEDURE: Civil § 1068 (1969 & Supp. 1982). Additionally, FED. R. CIV. P. 4(f) authorizes service of process anywhere within the territorial limits of the state in which the district court is held. FED. R. CIV. P. 4(f).

²³⁴ *Id.*

²³⁵ Both forum and foreign states' blue sky laws have been applied to regulate securities. See generally EHRENZWEIG, TREATISE ON THE CONFLICT OF LAWS § 146 (1962).

concludes that either of these conditions is met, it must determine whether the federal legislation and/or the insurance scheme eliminate(s) the risk to the investor. After *Marine Bank*, therefore, insurance schemes and federal legislation other than the securities acts have become more important in federal regulation of investment instruments.

In summary, by adding the requirements of risk and non-uniqueness to the *Howey* test, the Court in *Marine Bank* narrowed the class of instruments qualifying as securities for purposes of the federal securities acts. Consequently, the Court has made it more difficult for potential investors to sue in the federal courts under the federal securities acts. This heightened barrier to invoking federal court jurisdiction will force practitioners to consider very seriously state law causes of action, as well as federal remedies, and will force many plaintiffs to pursue their securities claims under common law and state blue sky legislation. Plaintiffs who are forced to seek state remedies will confront the procedural disadvantages of having no choice between suing under state or federal law, having to satisfy the state's possibly more limited personal jurisdiction requirements, and having to prove to a court which state's law governs the security. Finally, by adding the requirement of risk to the *Howey* test, the *Marine Bank* Court increased the importance of insurance schemes and federal legislation other than the securities acts in federal regulation of investment instruments.

C. A Critique of *Marine Bank v. Weaver's Risk and Non-Uniqueness Requirements*

Marine Bank's risk and non-uniqueness requirements do provide potential investors with some guidance for determining whether a borderline instrument qualifies as a security. Under these requirements, an instrument cannot be a security unless it is not too unique, and unless it involves some risk to the investor.²³⁶ *Marine Bank's* risk and non-uniqueness requirements, however, are problematic because the Court did not articulate a clear standard to determine whether an instrument complies with these requirements.

In concluding that the certificate of deposit was disqualified for purposes of federal securities law, the Court in *Marine Bank* did not engage in an in-depth analysis of how and why the federal banking regulations contributed to obviating the need for federal securities law.²³⁷ The Court's decision noted that *Marine Bank* was subject to comprehensive federal banking regulations, and that *Marine Bank's* deposits were protected by the reserve, reporting and inspection requirements of federal banking law.²³⁸ Based on this premise, the Court, without any further analysis of the protection afforded by the banking

²³⁶ See *supra* notes 164-203 and accompanying text.

²³⁷ The Court did indicate that the certificate of deposit was subject to federal banking laws. *Marine Bank v. Weaver*, 455 U.S. 551, 588 (1982). It did not, however, articulate an in-depth analysis comparing the protection afforded by the federal banking laws with the protection afforded by the securities acts.

²³⁸ *Id.* at 558.

regulations and laws, concluded that the need for the federal securities acts was undercut because the certificate of deposit in *Marine Bank* was "abundantly protected under the federal banking laws."²³⁹ The Court, however, did not demonstrate how and why the federal banking laws provided the holder of a certificate of deposit a degree of protection such that the risk to the holder was eliminated and the need for the federal securities acts was obviated. Consequently, *Marine Bank* does not provide clear guidance on either the depth of analysis or the amount of fact finding that a court must conduct before it determines that other federal legislation obviates application of federal securities law. Additionally, by not conducting an in-depth analysis, *Marine Bank* does not provide a clear signal as to how much risk is necessary to require the protection of federal securities law.

The Court in *Marine Bank*, however, did establish a clear standard to determine whether an insurance scheme eliminates the risk of a borrower's insolvency. The *Marine Bank* Court concluded that the Federal Deposit Insurance Corporation's insurance coverage eliminated the certificate of deposit's risk of loss because nearly all depositors in failing banks insured by the F.D.I.C. have received payment in full.²⁴⁰ *Marine Bank*, therefore, indicates that an insurance scheme does not eliminate the risk of a borrower's insolvency unless the insurance guarantees payment in full to nearly all investors protected by it.

In determining that the agreement between the Weavers and the Piccirillos did not constitute a security because it was too unique, the *Marine Bank* Court did not establish a clear standard to determine when an instrument passes its uniqueness requirement. In *Marine Bank*, the Court based its uniqueness conclusion on three findings.²⁴¹ First, the guarantee agreement was not offered to a number of potential investors.²⁴² Second, the provision that the Weavers could use the slaughterhouse's barn and pastures rendered the guarantee agreement unlike instruments that qualify as securities under the federal securities acts.²⁴³ Third, the Weavers' veto power over future loans provided them with a measure of control uncharacteristic of a security.²⁴⁴ Instead of articulating a clear standard for determining uniqueness, however, the Court merely identified the agreement's unique characteristics, and determined that those characteristics rendered the agreement too unique to con-

²³⁹ *Id.* at 558-59.

²⁴⁰ *Id.* at 558.

²⁴¹ For a further examination of the Court's determination that the agreement between the Weavers and the Piccirillos did not qualify as a security for purposes of the federal securities acts, see *supra* notes 183-203 and accompanying text.

²⁴² 455 U.S. at 559. In reaching this finding, the Court in *Marine Bank* did not provide a clear standard as to the number of potential investors an alleged security must be offered to before the alleged security qualifies for the federal securities laws' protection. In *Marine Bank*, the Court's holding is confined to the situation where an offer is made to only one potential investor. *Id.* Consequently, it is unclear how many potential investors an alleged security must be offered to before the alleged security passes *Marine Bank*'s non-uniqueness test.

²⁴³ *Id.* at 560.

²⁴⁴ *Id.*

stitute a security.²⁴⁵ Consequently, the Court's non-uniqueness requirement does not provide courts, practitioners and potential investors with a clear standard to determine how much uniqueness is permissible before an instrument is disqualified as a security.

In sum, the Court in *Marine Bank* did not formulate well-defined standards to determine whether an instrument qualifies under its risk and non-uniqueness tests. Consequently, the *Marine Bank* decision does not provide a clear signal as to how the risk and non-uniqueness requirements are to be applied. Given these inherent ambiguities, it is apparent that standards must be devised to aid in application.

D. *A Modification of Marine Bank's Risk and Non-Uniqueness Requirements*

Establishing clear standards for the application of *Marine Bank's* risk and non-uniqueness requirements is important because it provides practitioners, courts and investors with guidance in determining whether an instrument is within the pale of federal securities law. Proper standards must be structured such that the purpose for enacting the federal securities acts is attained.²⁴⁶ The primary purpose for enacting the Securities Act of 1933 and the Securities Exchange Act of 1934 was to eliminate abuses in a largely unregulated securities market.²⁴⁷ Hence, any test for determining which instruments qualify as securities should not allow the circumvention of the federal securities acts unless the purpose of these acts can be attained in an equally effective manner by other means.²⁴⁸ In this respect, the *Marine Bank* Court may have been incomplete in its risk and non-uniqueness analyses because it did not promulgate a clear standard on how these requirements should be applied to insure that the purposes of the federal securities acts are not frustrated. By failing to formulate a clear standard with respect to the risk and non-uniqueness requirements, the *Marine Bank* Court has created the danger that these requirements may be misapplied. If these requirements are misapplied, instruments may be disqualified for protection under the federal securities acts, when, in fact, they should be deemed deserving of such protection.

In concluding that the risk requirement was not satisfied by the Weavers' pledge, the *Marine Bank* Court failed to undertake an in-depth analysis of how and why the federal banking regulations attained the purposes of, and provided the protection afforded by the federal securities laws.²⁴⁹ The Court did cite the pertinent regulation, and indicated that the certificate of deposit was protected by reserve, reporting and inspection requirements.²⁵⁰ Nonetheless, the Court

²⁴⁵ *Id.* For a further examination of the Court's determination, see *supra* notes 183-203 and accompanying text.

²⁴⁶ For the purpose of enacting the federal securities acts, see *supra* note 4.

²⁴⁷ *Id.*

²⁴⁸ For the purposes of the federal securities acts, see *supra* note 4.

²⁴⁹ For a further discussion of the *Marine Bank* Court's failure to undertake an in-depth analysis of how and why the federal banking regulations attained the purpose of and the protection afforded by the federal securities acts, see *supra* notes 237-39 and accompanying text.

²⁵⁰ *Marine Bank v. Weaver*, 455 US 551, 558 (1982).

failed to explain how the risk requirement should be applied by the lower courts on a case-by-case basis. To remedy this fault, the following modification of the *Marine Bank* risk requirement is proposed. The federal securities acts should be available to a party seeking the federal securities laws' protection unless the opposing party can show that there is federal legislation other than the securities acts which, by *eliminating* the risk of loss due to fraud, exploitation or misrepresentation, obviates the *need* for the protection of the securities acts. Under this requirement, federal legislation other than the securities acts would displace the federal securities acts only when it provides protection *substantially equal* to that of federal securities law.²⁵¹ This recommended standard for *Marine Bank*'s risk requirement would guard against hasty and incomplete findings by requiring courts to look into the facts of each case and the specific legislation cited to determine whether the legislation provides protection substantially equal to that of federal securities law.

Concerning the existence of an insurance scheme, the modified version of *Marine Bank*'s risk requirement would read as follows. The federal securities acts should apply unless the opposing party can demonstrate that there is an insurance scheme which, by *eliminating* the risk of loss due to fraud, exploitation or misrepresentation, obviates the *need* for the federal securities acts' protection. Under this standard, courts would have to look into the facts of each case and the insurance scheme cited to decide whether the insurance scheme provides protection substantially equal to that of federal securities law. Consequently, this test would guard against findings that the mere existence of an insurance scheme, regardless of the nature and extent of its coverage, undercuts the need for federal securities law's protection.²⁵²

This proposed risk standard remedies the ambiguities of *Marine Bank*'s risk requirement. First, by placing the burden of proof on the party opposing application of federal securities law, it insures that courts conduct extensive fact finding and analysis. Second, the proposed standard indicates how much risk is necessary to require protection by the federal securities laws. If federal legislation other than the federal securities acts and/or an insurance scheme does not provide protection substantially equal to that provided by the federal securities acts, the instrument in question requires the federal securities acts' protection. If, therefore, federal legislation other than the federal securities acts and/or an insurance scheme do not eliminate at least as much risk as do the federal securities acts, then the instruments in question cannot be disqualified from

²⁵¹ Substantially equal protection exists only if the federal legislation other than the federal securities laws provides at least as much protection as is provided by the federal securities laws. Under this standard, the issue of whether federal legislation other than the federal securities laws displaces the federal securities acts is to be determined on a case-by-case basis.

²⁵² The mere existence of an insurance scheme does not obviate the need for the federal securities acts protection. An insurance scheme designed to protect an investor from a borrower's insolvency does not necessarily protect the borrower from the risk of loss due to fraud, exploitation or misrepresentation.

federal securities law on the grounds of risk. Furthermore, consistent with the purposes of the federal securities acts, the risk eliminated must be the risk of loss due to fraud, misrepresentation, or exploitation.²⁵³

As with the risk analysis, the Court in *Marine Bank* did not articulate a standard to determine whether an instrument passes its non-uniqueness requirement.²⁵⁴ The Court's analysis indicates neither the number of persons to which an alleged security must be offered,²⁵⁵ nor the degree of uniqueness to be tolerated before an instrument is rendered beyond the scope of federal securities law.²⁵⁶ Consequently, it does not provide courts, investors and practitioners with much guidance for determining whether an instrument passes the non-uniqueness requirement.

To remedy the possible confusion surrounding the *Marine Bank* non-uniqueness requirement, the correct standard, it is submitted, focuses on the inverse of a marketable instrument. Under this standard, federal securities laws are applicable unless the instrument in question is so unique that it is *incapable* of traveling through the public markets.²⁵⁷ In deciding whether an in-

²⁵³ This is consistent with the purposes of the federal securities acts. See *supra* note 4 for the purpose of enacting the federal securities acts.

²⁵⁴ For a further discussion of the *Marine Bank* Court's failure to articulate a standard to determine whether an instrument passes its uniqueness test, see *supra* notes 241-45 and accompanying text.

²⁵⁵ For a more comprehensive discussion of the Court's failure to establish a standard to determine the number of persons to whom an alleged security must be offered before it qualifies for federal securities law, see *supra* note 242.

²⁵⁶ For a discussion indicating that the *Marine Bank* Court did not articulate a standard to determine the degree of uniqueness to be tolerated before an instrument is disqualified for purposes of the federal securities acts, see *supra* notes 241-45 and accompanying text.

²⁵⁷ This recommended uniqueness standard follows the approach suggested by Professor Scott FitzGibbon. See FitzGibbon, *supra* note 4, at 912-48. Professor FitzGibbon argued that a security is a financial instrument eligible to participate in a public market. *Id.*

The recommended uniqueness standard is consistent with the *Marine Bank* Court's analysis. The *Marine Bank* Court distinguished the agreement between the Piccirillo and the Weavers from the instruments involved in *Joiner* and *Howey* on the grounds that the instruments in the latter two cases "had equivalent values to most persons and could have been traded publicly." *Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982). By distinguishing the agreement between the Weavers and the Piccirillo on these grounds, the Court implied that the agreement was incapable of traveling through the public markets, *i.e.*, incapable of being traded publicly. After distinguishing the agreement between the Weavers and the Piccirillo from the instruments in *Joiner* and *Howey*, the Court identified the unique aspects of the security. *Id.* Therefore, *Marine Bank* can be read as disqualifying the agreement between the Weavers and the Piccirillo on the grounds that the agreement's uniqueness rendered it incapable of traveling through the public markets. Furthermore, support for the recommended uniqueness standard is afforded by language in the dissent to the Third Circuit's opinion. The dissenting opinion indicated that the "agreement obviously is not in a standard form that could be issued to the public at large." *Weaver v. Marine Bank*, 637 F.2d 157, 166 (3d Cir. 1980) (Weis, C.J., dissenting). The recommended standard also finds support in language from *Joiner* and *Forman*. In *Joiner*, the Court noted that "the term 'security' was defined to include by name or description many documents in which there is *common trading* for speculation or investment." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351 (1943) (emphasis added). In *Forman*, the Court stated that the focus of the federal securities acts "is on the capital market of the enterprise system: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need

strument is unique to the point of disqualification, a court must look into the facts of each case and determine whether the unique aspect of the alleged security effects whether it has an equivalent value to most persons.²⁵⁸ If it is determined that despite the instrument's unique aspects, it has an equivalent value to most persons, then the instrument is *capable* of passing through the public markets, and survives the recommended uniqueness standard. Thus, it may constitute a security for purposes of the federal securities acts.²⁵⁹ If, however, it is determined that the instrument's unique aspects cause the instrument to have an unequal value to most persons, then the instrument is incapable of passing through the public markets. Consequently, it does not comply with the recommended uniqueness standard. This proposed uniqueness standard, therefore, remedies the potential confusion arising from the *Marine Bank* Court's failure to indicate the degree of uniqueness to be tolerated,²⁶⁰ by requiring that an instrument be disqualified on the grounds of non-uniqueness only if it is so unique that it is incapable of traveling through the public markets.

In summary, the standards here proposed for the risk and non-uniqueness requirements imposed on the *Howey* test by *Marine Bank* further refine the definition of "security." Hence, an instrument is an investment contract, and therefore is a security for purposes of the federal securities acts²⁶¹ if: (1) the investor invests money in a common enterprise²⁶² such that there is a separable element constituting consideration for the instrument,²⁶³ (2) the investor is led

for regulation to prevent fraud and to protect the interest of investors." *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975) (emphasis added).

²⁵⁸ This line of analysis draws support from *Marine Bank*. The *Marine Bank* Court distinguished the agreement between the Piccirillos and the Weavers from the instruments in *Joiner* and *Howey* on the grounds that the instruments in the latter two cases "had equivalent values to most persons and could have been traded publicly." *Marine Bank v. Weaver*, 455 U.S. 551, 560 (1982) (emphasis added). By distinguishing the agreement in question in *Marine Bank* on these grounds, the Court implicitly indicated that to be capable of being traded publicly (being able to travel through the public markets), an instrument must have an equivalent value to most persons.

For a discussion relating an instrument's degree of uniqueness to the ability of the public markets to perform their pricing function, see FitzGibbon, *supra* note 4, at 929. If an instrument is so unique that it does not have an equivalent value to most persons, then the public markets cannot perform their pricing function. *Id.* Consequently, the instrument is not capable of passing through the public markets. *Id.*

²⁵⁹ The instrument, however, must pass all three *Howey* requirements as well as the two recommended risk and non-uniqueness standards before it qualifies as a security for purposes of the federal securities acts. For a listing of the three *Howey* requirements with the recommended standards of risk and non-uniqueness, see *infra* notes 261-69 and accompanying text.

²⁶⁰ For an examination of the potential confusion arising from *Marine Bank*'s non-uniqueness requirement, see *supra* notes 241-48 and accompanying text.

²⁶¹ For the text of the statutory definitions of a security, see *supra* note 7. Included in these definitions is the term *investment contract*. *Id.*

²⁶² *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99 (1946). For a discussion of the issue of whether only "horizontal commonality" satisfies the common enterprise requirement, see *supra* note 91.

²⁶³ *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 559-60 (1979).

to expect profits²⁶⁴ that cannot be in the form of a commodity for personal consumption,²⁶⁵ and (3) the expected profits are gained solely²⁶⁶ through the entrepreneurial or managerial efforts of others.²⁶⁷ If these three requirements are met, the instrument is a security within the meaning of the securities acts unless: (1) the party seeking to disqualify the instrument can show that there is an insurance scheme and/or federal legislation other than the securities acts which, by *eliminating* the risk of loss due to fraud, exploitation, or misrepresentation, obviates the need for the securities acts' protection,²⁶⁸ or (2) the instrument is so unique that it is incapable of traveling through the public markets.²⁶⁹

CONCLUSION

In determining that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos were securities, the *Marine Bank* Court narrowed the class of instruments constituting securities by adding the requirements of risk and non-uniqueness to the classical *Howey* test. By so narrowing what constitutes a security for purposes of the federal securities acts, the *Marine Bank* Court has made it more difficult for potential investors to sue in federal courts under the federal securities acts. Consequently, more investors will be forced to pursue their security claims in the state courts under common law and state blue sky laws. Accordingly, after *Marine Bank*, common law and state blue sky laws have become more important in securities law. Moreover, in the wake of *Marine Bank*, insurance schemes and federal legislation other than the securities acts have acquired increased significance since *Marine Bank*'s risk requirement 'disqualifies' an instrument if federal legislation other than the securities acts and/or an insurance scheme eliminate(s) the risk to the investor. Finally, in promulgating the risk and non-uniqueness requirements, the *Marine Bank* Court failed to establish clear standards for determining whether an instrument complies with these requirements. Consequently, *Marine Bank* does not give courts, practitioners or investors much guidance for determining whether an instrument passes its risk and non-uniqueness requirements. The standards proposed for *Marine Bank*'s two requirements remedy this problem by providing measures against which courts, practitioners and investors can determine whether an instrument is a security. By so doing, the casenote's proposed standards provide greater guidance in determining whether an instru-

²⁶⁴ SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

²⁶⁵ United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975).

²⁶⁶ The requirement that the profits result *solely* through the efforts of others has been relaxed. See *supra* note 92.

²⁶⁷ United Hous. Found., Inc., v. Forman, 421 U.S. 837, 855 (1975) (requirement that efforts of others be entrepreneurial or managerial); SEC v. W.J. Howey Co., 328 U.S. 293, 299 (1946).

²⁶⁸ For a further discussion of this recommended risk standard, see *supra* notes 246-53 and accompanying text.

²⁶⁹ For a further discussion of this recommended uniqueness standard, see *supra* notes 254-60 and accompanying text.

ment is a security for purposes of the federal securities acts. Since courts are given more guidance under these recommended standards, the standards increase the likelihood that *bona fide* securities will not be mistakenly excluded from the federal securities acts' protection.

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