10-1981

Marine Bank v. Weaver

Lewis F. Powell Jr.

Paul - may I see papers. I don't understand this case. Who is issuer?

Referred to Dewey

CA 3 erroneously held that a Certificate of Deposit may be a "security". But case has not been treated.

The first Q in this case is whether, as CA 3 held with one dissent, a Certificate of Deposit already outstanding is a "security" under '33 & '34 acts.

Resps ~~bought~~ owned a C/D they had bought ~~for~~ from Bank. They subsequently "pledged" C/D to the Bank as accommodation endorsers of a 3rd Party's loan. When Bk sought to enforce it "pledge", Resps. sued claiming C/D was a security & that Bank had persuaded them to surrender it by false statement - a transaction involving a "security". These certificates of deposit are becoming increasingly important. The Court should decide whether they are securities. Paul C

Preliminary Memo

May 28, 1981 Conference
List 1, Sheet 2

No. 80-1562

MARINE BANK

v.

SAMUEL
and ALICE
WEAVER

Timely

Cert to CA 3
(Gibbons & Sloviter; Weis, dissenting)
Federal/Civil

1. SUMMARY: Petr contends: (1) An FDIC-insured, non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security" under the 1933 Act or the 1934 Act; and (2) a written agreement providing, inter alia, that resps would receive 50% of the profits of a business, did not create a "security" under the 1933 Act or the 1934 Act.

2. FACTS & DECISION BELOW: In 1976, Marine Bank made several loans to Columbus Packing Company, an unincorporated business owned by Mr. and Mrs. Piccirillo. Columbus Packing operated a wholesale slaughterhouse and a retail meat market. In 1978, concerned that the Piccirillos would be unable to repay these loans, Marine Bank negotiated a new loan agreement with Columbus Packing. The bank loaned Columbus Packing $65,000, secured by security interests in equipment, inventory, and accounts receivable, liens on motor vehicles, and liens on two pieces of real estate. Mr. and Mrs. Weaver, who were farmers engaged in auctioning livestock, guaranteed payment of the Piccirillos' debt up to $50,000. They pledged to the bank a $50,000 certificate of deposit that Marine Bank had issued to them. This certificate of deposit earned a fixed rate of interest, payable in six years. Prior to closing on the loan, the guaranty agreement, and the pledge, the Piccirillos and the Weavers entered into a written agreement which provided that the Weavers would receive 50% of the adjusted net profits of Columbus Packing so long as the Weavers remained co-obligors, that the Weavers would receive $100 per month until the loan was repaid, that the Weavers could veto any future loans to Columbus Packing, and that the Weavers could use the barn and pasture on the packinghouse premises at the discretion of the Piccirillos.

The Piccirillos used the proceeds of the $65,000 loan to repay past loan and overdraft obligations, to pay federal taxes, and to repay creditors. This left only $3800 for working capital. Four months later, Columbus Packing filed a bankruptcy

petition. Marine Bank sought to resort to the Weavers' pledged certificate of deposit, since the bank's security and Columbus Packing's property were inadequate to repay the loan.

The Weavers filed suit in USDC, claiming that Marine had violated §10(b) of the 1934 Act, §17(a) of the 1933 Act, and the Pennsylvania Securities Act. The DC granted summary judgment for Marine Bank, holding as a matter of law that the certificate of deposit was not a security and that the written agreement between the Weavers and the Piccirillos did not create a security.[1] A divided CA reversed, holding:

> "From the pleadings, affidavits, and depositions on file, . . . a fact-finder could find that . . . employees of the bank approached the Weavers and urged them to make an investment in Columbus Packing for the purpose of providing working capital. . . . Further, it could be found that the Weavers . . . were persuaded to pledge their Certificate of Deposit in exchange for a $65,000 loan to Columbus Packing on the representation that substantially all of the loans would be available to that business for working capital, and on the representation that the existing collateral adequately protected both their interest and the bank's. . . .
>
> "A fact-finder certainly could on the record before us find that the bank's manipulative and deceptive conduct, if it took place, was in connection with the execution and delivery of an agreement between the Piccirillos and the Weavers by which, in consideration of their pledge of a $50,000 Certificate of Deposit to enable Columbus Packing to obtain a working capital loan, they were given a 50% interest in the anticipated profits of the Piccirillo's slaughterhouse."

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[1] I have attached the definition of "security" under the Securities Exchange Act of 1933 and the Securities Exchange Act of 1934.

(1) The agreement between the Weavers and the Piccirillos could be found by a trier-of-fact[2] to be a certificate of interest or participation in a profit-sharing agreement, or an investment contract, or both. (a) The classic example of a certificate of interest or participation in a profit-sharing arrangement cited by Professor Loss is a contract whereby the buyer furnishes funds and the seller the skill for speculating in the stock or commodities market under an arrangement to split profits. See 1 Loss, Securities Regulation 489. There is no reason why a sale of an interest in the future profits of a slaughterhouse should be treated differently. (b) In SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), the Court stated that the test for distinguishing an investment contract from a mere commercial or a consumer transaction is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." The DC erred in holding as a matter of law that this agreement was not an investment contract.[3]

(2) The DC also erred in holding as a matter of law that the certificate of deposit was not a security. In Tcherepnin v.

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[2] The court explained that it spoke in terms of what a jury could find because it was reviewing a grant of summary judgment. "We do not imply that absent some issue of fact raised by the defendant the issue should not be decided as a matter of law." A-7, note 3.

[3] The CA acknowledged that a fact-finder could decide in favor of Marine Bank on this issue if it determined that use of the barn and pasture was the primary purpose of the transaction.

Knight, 389 U.S. 332 (1967), the Court held that withdrawable capital shares in a savings and loan association were securities. Although Tcherepnin is not controlling, it is difficult to distinguish long-term deposit transactions with institutions such as the savings and loan in Tcherepnin from similar deposit transactions with banks. Furthermore, the SEC has taken the position that certificates of deposit issued by banks are securities.[4]

Judge Weis dissented, stating: (1) The transaction between the Weavers and the Piccirillos did not create a security, since the arrangement did not involve multiple investors, use of a public market, or a public offering. This type of transaction should be regulated under state law. (2) The certificate of deposit was not a security. Tcherepnin is not on point. The shares involved in that case entitled the holders to a share of the profits and they were transferrable. A certificate of deposit is more like a savings account than it is like a bank's capital stock. See Bellah v. First National Bank of Hereford, 495 F.2d 1109 (CA5 1974) (CA rejected various arguments plaintiffs made to support their contention that a certificate of deposit is a security, yet it permitted plaintiffs to pursue the

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[4] The CA also held that the pledge of the certificate of deposit constituted a "sale" of a security.

The CA concluded the opinion by remarking that the DC's opinion displayed a "general tone of nostalgia for the days when victims of fraud were relegated to the common-law remedy of deceit." The CA asserted that the federal courts "ought to interpret the 1934 Act with a presumption of coverage of any transaction which Congress did not expressly exclude."

issue on remand); Canadian Imperial Bank of Commerce Trust Co. v. Fingland, 615 F.2d 465 (CA7 1980) (CA held that the allegations of the complaint did not establish that the certificate of deposit involved in that case was a security). But see SEC v. First American Bank & Trust Co., 481 F.2d 673 (CA8 1973) (certificates of investment and savings accounts characterized as "securities"). The ALI's proposed Federal Securities Code specifically excludes from the definition of "security" a "bank certificate of deposit that ranks on a parity with an interest in a deposit account with the bank."

3. CONTENTIONS: Petr contends: (1) An FDIC-insured non-equity certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security," as defined in the 1933 Act or the 1934 Act. The CA's decision conflicts with Canadian Imperial Bank of Commerce Trust Co. v. Fingland, supra, and Bellah v. First National Bank of Hereford, supra. Although the SEC has taken the position that certificates of deposit issued by banks are securities, there is nothing in the language or the legislative history of the 1933 or 1934 Acts to support this position. The Glass-Steagall Act generally prohibits banks from underwriting, buying, or selling equity securities. Under the CA3's decision, many commercial banks would be violating the Glass-Steagall Act by accepting certificates of deposit. The CA erred in relying on Tcherepnin, supra, for the shares at issue in that case were withdrawable capital shares that carried a right to vote and were not entitled to a fixed rate of return. The certificate of deposit involved

in this case carried no voting rights, paid a fixed rate of interest, and did not represent shares in the bank.

(2) The written agreement between the Piccirillos and the Weavers did not constitute a "security" under the 1933 or the 1934 Act. This was a private arrangement between two married individuals. Mr. Weaver did not pool his investment with anyone, and there was no public offering or advertising. The CA thus misapplied the criteria for a "security" under the 1933 Act, as set forth in SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), and as extended to the 1934 Act in Tcherepnin, supra. Furthermore, Marine Bank could not have acted with scienter with respect to this agreement, since it had no knowlege of the agreement.

Resps reply: (1) Resps do not argue that the original purchase of the certificate of deposit from Marine Bank constituted a purchase of a security under the 1933 or 1934 Act. Rather, they argue that the exchange of the certificate of deposit, by way of the pledge, for investment purposes constituted a sale of a security under the 1933 and 1934 Acts.[5] Since this was an investment transaction rather than a traditional commercial banking transaction, the CA's holding will have little effect on the banking industry.

(2) Although petr contends that the written agreement was

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[5] Resps also assert that the Court's recent decision in Rubin v. United States disposes of the first question presented--"namely that the pledge of the Certificate of Deposit for the loan constitutes the purchase and sale of a security under the Securities Acts." However, petr does not argue in the cert petn that the pledge was not a sale.

not an investment contract, petr does not challenge the CA's alternative holding that the agreement could be considered a certificate of interest or participation in a profit-sharing agreement. In this case, there was a pooling of Weaver's capital with Piccirillo's equipment and labor, and Weaver's return on his investment was contingent upon this combination of capital and labor producing profits. A "security" may be involved even if there is no public offering or advertising. See, e.g., Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971); Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972).

(3) The CA did not suggest that petr could be held liable without proof of scienter. Weaver is not claiming that the bank acted negligently, but rather that it intentionally defrauded him out of his $50,000 certificate of deposit.

4. DISCUSSION: I recommend a CFR SG to explore the issue of whether a certificate of deposit may be considered a "security." I agree with petr that Tcherepnin is easily distinguishable, since the securities involved in Tcherepnin were capital shares that were transferrable, carried the right to vote, and entitled the holder to a share of the savings and loan association's profits. The Court emphasized that the holders of these shares were not entitled to a fixed rate of return. 389 U.S., at 337. I do not understand resps' argument that even if this certificate of deposit was not a "security" when purchased, it was a security when it was pledged.

I am less troubled by the CA's holding that the written

agreement between the Weavers and the Piccirillos could be viewed as creating a "security." The CA concluded that a trier of fact could regard this as a profit-sharing arrangement, since the Piccirillos provided the labor, the Weavers essentially provided working capital, and in return the Weavers acquired an interest in the future profits of the business.

There is a response.

5/18/81	Peterson	Opinion in Petition

ME

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

> (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 Exchange Act of 1934, 15 U.S.C. § 78c(a)(10):

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

Court ..... Voted on ....., 19...

Argued ....., 19... Assigned ....., 19... No. 80-1562

Submitted ....., 19... Announced ....., 19...

MARINE BANK

vs.

WEAVER

Byron says there is a conflict & this could not be a security. I would recommend to deny, as case may not be important. Byron, P.S. a WHR would Grant & Rev

Granted.

	HOLD FOR	CERT.		JURISDICTIONAL STATEMENT				MERITS		MOTION		ABSENT	NOT VOTING
		G	D	N	POST	DIS	AFF	REV	AFF	G	D		
Burger, Ch. J.			✓										
Brennan, J.			✓										
Stewart, J.		✓											
White, J.		✓											
Marshall, J.			✓										
Blackmun, J.			✓										
Powell, J.		✓											
Rehnquist, J.		✓											
Stevens, J.		✓											
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Reviewed 1/8/82
Mary would reverse. I agree on both Qs. CA3 went off the "deep end"!

meb 01/08/82

BENCH MEMORANDUM

To: Mr. Justice Powell January 8, 1982

From: Mary

No. 80-1562, Marine Bank v. Samuel and Alice Weaver (CA3 - Weis dissenting)

Questions Presented

The major question is whether a certificate of deposit is a security subject to the anti-fraud provision of the Securities and Exchange Act (SEA) of 1934 when it is pledged to the issuer as collateral for a guarantee of a loan. The other question is whether

a unique agreement between the guarantors and the borrowers is a security under the Act, and, if so, whether, on the facts of this case, the Bank is liable for fraud in the sale of that security.

I. BACKGROUND

A. Facts and Proceedings Below

Because of the procedural posture of the case (the DC granted summary judgment against the pltfs), I will present the facts (briefly) according to pltfs' (resps) view of them.

Between 1976 and 1978, petr Marine Bank had loaned $33,000 in demand loans to Columbus Packing Co. (Columbus) (a slaughterhouse and retail meat store owned and operated by Raymond and Barbara Piccirillo) Because of the Bank's failure to perfect its security interest in Columbus' assets, it did not have a secured position as of Mar. 17, 1878. All loans were overdue on Jan. 16, 1978, and Columbus was unable to make any interest or principal payments on that date or thereafter. In addition, Columbus's checking account was overdrawn by $7,758.77 (this account had been overdrawn almost constantly since Apr., 1977, with an average overdraft of $9,000).

In order to reduce its exposure, the Bank first tried to get the Small Business Administration to loan Columbus money. When this fell through, the Bank approached the Weavers (who had recently purchased a 5-year $50,000 CD from the Bank) and suggested that they guarantee a loan of $65,000 to the Piccirillos to improve their working capital-position. In 1978, Sam and Alice Weaver were retired farmers, with eighth grade educations, 78 and 71 years old respectively. The Bank's representative stated that with their

guarantee, the Bank would offer a $65,000 loan to Columbus, substantially all of which would go to the business as working capital. The Weavers were never told that Columbus was indepted to the Bank or that Columbus had any serious financial problems. The Bank did tell the Weavers that there was little risk in their guarantee, that the bank had perfected security interests in Columbus' equipment and working capital and that the value of this collateral was enough to protect the Bank and the Weavers.

In reliance on these representations, the Weavers entered into an agreement with the Picirrillos, to which the Bank was not a party. In return for the guarantee, the Weavers were given the following rights: (1) use of the barn and pasture on the slaughterhouse premises; (2) 50% of the "adjusted net profits" of Columbus Packing so long as the Weavers remained co-obligors; (3) $100 a month until the loan was repaid; and (4) veto of any future loans to Columbus. According to the Weaver's own tesimony, they never told the Bank about agreement, which was prepared by the Picirillos' lawyer and signed at the Weavers' house shortly before March 17, 1978.

On March 17, 1978, the Weavers pledged their CD to the Bank and the Bank loaned Columbus $65,000. Of that amount, $42,515.37 went to cover the loans and overdrafts held by the Bank itself, most of the rest went directly from the Bank to trade creditors and to the IRS. Only $3,833.06 was available to Columbus for working capital. The Bank never had any reasonable expectation that the loan would be repaid by Columbus. On May 9, Columbus closed its business due to lack of capital; it filed for bankruptcy in July.

The Bank refuses to return the CD to the Weavers and concedes that foreclosure is inevitable.

On May 4, 1979, the Weavers filed a complaint in DC. They claimed that the Bank had violated Pa. securities law, the common law of fraud, and federal rule 10b-5 (enforcing SEA §10b) in connection with the sale or purchase of two securities, the CD and the Weaver-Picarrillo agreement (the W-P agreement).

On Jan. 11, 1980, the DC (Willson) dismissed the action. It held that neither the pledged CD nor the W-P agreement was a security for purposes of the federal security laws. The pendant state claims were dismissed because the DC could "find no subject matter juisdiction [over the federal claims] under the statute involved."

The CA3 (Gibbons & Sloviter) (Weis dissenting) reversed, holding that both the CD and the W-P agreement were securities. The CA also reversed the dismissal of the state-law claims, so that, on remand, the DC could decide whether they should be tried with the federal claims.

The propriety of the remand of the pendant claims is not included in the questions on which cert was granted. The two questions presented are: was the pledge of the CD the pledge of a security for purposes of §10(b) liability? was the W-P agreement a security and, if so, can the Bank be held liable for fraud in its sale to the Weavers?

B. The Regulatory Framework

In March of 1933, President Roosevelt sent to Congress the

bill that was to become the Securities Act of 1933. At that time, he expressed the view that bank regulation should be embodied in separate legislation. See 77 Cong. Rec. 937 (1933). Shortly thereafter, a Senate resolution authorized the Senate Committee on Banking and Currency to continue its investigations of the practices of companies engaged in "the business of banking" and companies engaged in the securities business. S. Res. 56, 73rd Cong., 1st Sess. (1933). As a result of these and earlier investigations, Congress enacted the Securities Act of 1933, 15 U.S.C. §77a et seq., the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq., and the Banking Act of 1933 (commonly known as the Glass-Steagall Act).[1]

As the Court pointed out in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) (Powell, J.), the securities acts were intended to protect investors against fraud and manipulation of stock prices by (1) regulating transactions in the securities exchanges and in the over-the-counter markets; (2) imposing specified civil liabilities to promote ethical standards of honesty and fair dealing; and (3) imposing reporting requirements applicable to companies whose stock is listed on the national securities exchanges. Id., at 195 (citing H. Rep. No. 85, 73rd Cong., 1st Sess., 1-5 (1933) and S. Rep. No. 792, 73rd Cong., 2d Sess., 1-5 (1934). In contrast, the Glass-Steagall Act focused on the interests of depositors and provided a comprehensive scheme of regulation over many aspects of the operation and management of

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[1] 48 Stat. 162, codified in various sections of title 12 of U.S.C.

banking institutions.

Initially, all the federal regulators apparently assumed that the securities acts did not apply to bank deposits, including CDs. By 1966, however, the SEC, the FDIC, the Comptroller of the Currency, the Federal Home Loan Bank Board, and the Federal Reserve System, all seem to have agreed that even "savings deposits" were securities covered by the acts. See FDIC, Statement of Policy on Advertising for Funds by Insured State Nonmember Banks, 31 Fed. Reg. 16,581 (1966).[2] But by 1974, the FDIC and the SEC wre filing opposing briefs in cases involving CDs issued by state-chartered federally insured (and regulated) banks, with the FDIC arguing that the securities acts did not apply. SG brief at 2, n.1. And by 1976, the Comptroller was agreeing with the FDIC. Id. These disagreements were resolved in preparing the brief of the government to this Court in this case. The new unanimous position of the executive is that "deposits," including CDs, of federally-insured (and therefore federally-regulated) banking institutions are not securities at the time of issue.

Despite the varying views of the executive, the courts seem to have generally assumed that bank savings accounts are equivalent to currency and not securities for purposes of the securities acts. See Burrus, Cootes & MacKethan, 567 F. 2d 1262, 1264 (CA4 1976).

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[2]This interpretation seems to have initiated with the SEC, possibly in response to increased bank advertising for deposits during the sixties. Those advertisements were regarded as misleading; items such as interest rates and whether or not rates were compounded daily or monthly were not always clearly and simply stated.

CD's not included in long list

The question before the Court is whether a bank CD is a deposit account or a security. Most of the lower courts considering the question have held that certificates of deposit issued by federally regulated banks are not securities. See cases collected in SG's brief n.32, at 20.

II. DISCUSSION

A. Is a CD a Security?

1. The language of the statute and its legislative history. Section 3(a)(10) of the SEA, 15 U.S.C. §78c(a), provides that:

> "When used in this chapter, unless the context otherwise requires ...
> (1)) 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 time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

1933 Act

Congress included every item that, in the view of the legislators, might be thought to be a security and added a catchall phrase to cover exotic or unusual transactions or anything that might be invented later with the same characteristics or possibilities for abuse that known securities had. See H.R. Rep. No. 85, 73rd Cong., 1st Sess. 11 (1933). At that time, certificates of deposit were a

known and common part of the banking business. A federal statute had explicitly authorized their issuance by banks since 1913. Federal Reserve Act §19, 38 Stat. 270. Congress' failure to include this known commodity by its common name suggests that Congress did not consider CDs securities.

Congress did include "certificates of deposit, for a security." Thus, the statute included receipts of the CD-type, but only for items already securities.[3] A bank deposit is not a receipt for a security--it is a receipt for an unpaid balance of money or its equivalent, 12 U.S.C. §1813, and money is not a security. A CD is merely one form of savings (not investment) device available for bank depositors (not investors).

The legislative history shows affirmatively that Congress did not intend to include deposit instruments issued by commericial bank within the term "securities." At the House Hearings, in response to a question from Representative Mapes relating to the coverage of the proposed §3(a), quoted above, defining "security." Huston Thompson, one of the draftsmen of the bill, explained that while the bill would encompass "any kind of a security of a national bank," he did not suppose a national bank would be putting out anything in addition to its capital stock." Federal Securities Act: Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce, 73rd Cong., 1st Sess. 31 (1933).

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[3]This type of receipt was commonly used in corporate reorganizations. See 1 Loss, Securities Regulation 460, 462 (2d ed. 1961).

There is also evidence that, in considering the bill that became the Securities Exchange Act of 1934 (SEA), Congress viewed the economic interests of depositors as distinct from those of investors, and it was the interest of investors that received special protection under the securities laws. During the Senate hearings, Senator Adams, a member of the Banking and Currency Comm., and Algbert Wiggin, a witness and former banker, emphasized that safety of principal was far less a problem for depositors than investors. Stock Exchange Practicers: Hearings on S. Res. 84 and S. Res. 56 Before the Senate Comm. on Banking and Currency, 73rd Cong., 2d Sess. 2426-2427 (1934).

Moreover, the Glass-Steagall Act, enacted on June 16, 1933, provided that it was illegal for any entity engaged in the business of selling, issuing, underwriting, or distributing "securities, to engage at the same time in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the debtor." Act §21(a)(1), current version at 12 U.S.C. §378(a). This provision was enacted a mere 19 days after the passage of the Securities Act of 1933, which has a definition of security virtually identical to the the definition in the 1934 SEA whose meaning is at issue in the case at bar. This suggests that Congress both knew how to say CD when it meant CD and that CDs are not securities--if they were, it would be illegal for banks to engage in the business of issuing them.

Given the wording of the definition of "security" and the legislative history of the acts, it seems fairly likely that a CDs

were not included when Congress used the term "security." This result receives further support from the decsions of this Court considering whether various interests are securities and the decisions of the CAs on the status of both CDs and on notes.

2. S. Ct. caselaw. In the past, the Court has interpreted the word "security" to refer to an investment in a for-profit enterprise run by another. Three S. Ct. cases are of most relevance to the case at bar. In Tcherepnin v. Knight, 389 U.S. 332 (1967) (Brennan, J.), the Court held that a withdrawable capital share in a state-chartered savings and loan (S & L) was a security. Under Ill. law, the holders of the shares were members of the S & L ass'n and entitled to vote on ass'n matters, much like shareholders in regular corporations. Id., at 336. The holders of these shares were not entitled to a fixed rate of return, but instead were entitled to whatever dividends might be declared from time to time by the Board of Directors. Id., at 337. The S & L was uninusred, so shareholders stood to lose any money they had in the S & L in the event of insolvency. And the legislative history, discussed above, suggested that the shares were securities because it indicates that Thompson, one of the drafters, expected national banks to issue securities in the form of capital stock--items quite similar to the S & L's (withdrawable) capital shares.

Although, to an S & L "depositor," withdrawable capital shares may be functionally equivalent to a bank deposit or CD, Tcherepnin does not control the case at bar. The Weavers did not purchase anything similar to a share of stock. They had no right to

vote. They contracted for a fixed rate of return over a fixed period of time. Marine Bank is insured by the FDIC so that in the event of insolvancy, a substantial amount of their funds would be recoverable. And the legislative history suggests that a CD is not a security; Thompson thought that capital shares were the only securities banks would be issuing.

In United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975) (Powell, J.), the Court held that shares in a cooperative apartment were not securities. The Court noted that the purchasers of apartments were required to buy 18 shares of stock for each room at a cost of $25. A tennant terminating occupancy was required to offer his stock to the cooperative for $25. The Court explained that these shares

> "lack what the Court in Tcherepnin deemed the most common feature of stock: the right to receive 'dividends contingent upon an apportionment of profits.' 389 U.S., at 339. Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothicated' they confer no voting rights in proportion to to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsudized low-cost living space; it was not to invest in profit." Id., at 851.

The Court stressed that the key attribute of a security is the presence of an investment in a common venture motivated by a reasonable expectation of profits to be derived solely from the entrepreneurial or managerial efforts of others. Id., at 851.[4]

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[4]The classic formulation of the test for a security was given in SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946). There, the Court explained that the basic test is "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." See also Teamsters v. Daniels,

Footnote continued on next page.

Under this test, the CD would not appear to be a security. It represents an amount deposited with the bank, returning a set amount of interest, with minimal risk, rather than an investment in a common enterprise subject to the risks of gain and loss of the enterprise.

3. Relevant decisions of the CAs. At least two CAs[5] have considered this question--whether bank CDs issued by federally insured banks are securities--in addition to the CA below: the CA4, & CA7.

(a). The CA4. In Burrus, Cootes and Burrus v. MacKethan, 537 F. 2d 1262, withdrawn as moot, 545 F. 2d 1388 (CA4 1976), cert denied, 434 U.S. 826 (1977), the CA4 held that "certificates of investment" issued by a savings and loan are not securities within the meaning of the acts. Under state law, savings and loans were allowed to issue such certificates, and the certificates were (under

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439 U.S. 551 (1978) (Powell, J.) (holding that employees' interests in a pension plan are not securities).

[5]See also SEC v. Fifth Avenue Coach Lines, Inc., 289 F. Supp. 3, 31-33 (SDNY 1968), aff'd, 435 F. 2d 510 (CA2 1970) (CD not a security for purposes of the Investment Company Act); Bellah v. First National Bank of Herefore, 495 F. 2d 1109 (CA5 1974). In Bellah, the pltfs argued that CDs issued by a bank was a security. The court noted that a certificate of deposit (issued in exchange for currency) is not a "certificate of deposit, for a security." On the basis of the arguments presented to it, the CA concluded that a CD is not a securtiy, though it remanded for further development of this point, as the DC had not addressed it.

The CA8 has held that CDs of non-federally regulated (non-insured) state banking institutions are securities. SEC v. First American Bank and Trust Co., 481 F. 2d 673, 677 (CA8 1973).

state law) regarded as equivalent to CDs issued by banks. The relation created by the certificate was debtor-creditor; the bank was liable to pay back the money at a certain time and at a certain interest rate.

The CA4 regarded this certificate as "not distinguishable in any significant way from a pass-book issued by a savings bank, and it is hardly arguable that savings bank account books are securities rather than the equivalent of currency." Ibid. The court also relied on (1) the fact that the definition of "security" includes "certificates of deposit, for a security," but not certificates of deposit and (2) the fact that if certificates of deposit were securities, "there would be superimposed upon an already existing pattern of federal or state banking or like regulations ... a further, and perhaps not wholly suitable, pattern of regulations by the SEC." Id., at 1265.

(b). CA7. In Canadian Imperial Bank of Commerce Trust Co. v. Fingland, 615 F. 2d 465 (CA7 1980), the plffs argued that trust funds were invested by Bahamian banking and trust entity, as trustee, in its own CD, whose terms and conditions were not described by plffs. The court held that the plffs had failed to show the existence of a security, relying, like the CA4, on the exclusion of the words "certificate of deposit, for a security," and the absence of "security of deposit." The court also applied the "investment-in-an-enterprise" test developed by the Court and discussed above. The CA also noted that under the 1933 Glass-Steagall Act,[6] as discussed above, it is unlawful for any person or

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Footnote(s) 6 will appear on following pages.

organization to engage in issuing securities and at the same time engage in banking operations, such as issuing certificates of deposit.

(c). The CA3 below. The CA3 (Gibbons & Sloviter) reasoned that, although Tcherepnin (holding withdrawable capital shares in an S & L a security) was not controlling, "functionally, from the depositor's standpoint, it is hard to distinguish long term deposit transactions with mutual institutions from similar deposit transactions with banks operated for the profit of stockholders." The court also relied heavily on the fact that when Tcherepnin was written, the SEC, FDIC, et al., unanimously agreed that deposit and share accounts of banks were securities for purposes of the fraud provisons of the securities acts, a position maintained before the CA3 below by the SEC (though now abandoned). The CA3 thought the Tcherepnin Court must have been aware of the agencies' position and somehow (silently) depended on it in reaching its decision. The CA3 held that a CD is the functional equivalent of a corporation's bond or note and therefore a security.

4. Relevant decisions of the CAs on the status of notes. In concluding that a CD was a security because it was equivalent to corporate bonds and notes, the CA3 ignored the fact that the lower courts[7] have not treated all notes as securities. Instead, the

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[6]Act of June 16, 1933, ch. 89, §21, 48 Stat. 189, current version at 12 U.S.C. §378(a)(1).

Footnote(s) 7 will appear on following pages.

lower courts have tried to distinguish between those notes that are truely investments in the borrower--the prototypical example being bonds and notes traded in the securities market, with the interest rate varying with the investment risk--and a pure "loan," usually referred to as a "commercial note."[8] The lower courts have adapted the factors developed by this Court in cases such as Forman, and have attempted to determine whether the lender should be considered an investor in a joint enterprise, subject to the risks of success and failure, or a purely commercial lender, lending for interest with minimal risk and relatively indifferent to the success of the

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[7]The Court has never considered a case dealing with whether a debt instrument is a security.

[8]The "commercial-investment" distinction has developed in the CA5 and the CA7. See Sonnenschien, Antifraud Provisions of Note Transactions, 35 Business Lawyer 1567, 1589-1596 (1980). The CA9 has adopted a variation, under which the focus is whether the lender has generated risk capital. These approaches have been criticized as unworkable. See id., at 1589-1605.

Judge Friendly has joined in this criticism, and would start with the presumption that a note is a security (because "note" is included in the language of the definition), but would allow the issuer to show that this note is not a security. His examples of notes that are not securities are:

> "the note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a "character" loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account dept incurred in the ordinary course of business ...." Exchange National Bank v. Touche Ross & Co., 544 F. 2d 1126, 1138 (CA2 1976).

The American Law Institute would codify the "mercantile-investment dichotomy that is emerging as the least imperfect solution to a troublesome problem." American Law Institute, Federal Securities Code--Proposed official Draft, at 159 (1978).

enterprise. A fully collateralized loan is usually not an investment.

Even if the CD had "note" instead of CD stamped on it,[9] it would not be a security. It does not represent an investment in Marine Bank, but rather a deposit of unneeded money with the bank to be re-paid at a set interest rate with little risk.

4. The SG's position. The SG has taken the position that the CD issued to the Weavers is not a CD--but he's not so sure about others. The SG suspects that a CD issued by a non-federally regulated institution might be a security. He also feels that the trading of CDs "in the secondary market" might present a "different" situation. And he maintains that a CD should be considered a security for purposes of the 1940 Investment Co. Act, though the definition of security in that act is identical to that in the SEA (1934).

The SG's position must be the result of compromises between the various regulators--it certainly is not the result of logic or rational analysis. The SEC apparently wants to maximize its jurisdiction, but is willing to concede that where the FDIC and the

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[9]The SG maintains that CDs "could be found to fall within th[e literal] definitional language, ..." SG brief at 10. The SG begins this argument by noting that the 1934 act's definition (the relevant one) includes the terms "note" and "debenture." And the Court has construed the 1934 definition as "virtually identical" to the 1933 definintion. And the 1933 definition includes "any evidence of indebtedness." Thus, concludes the SG, a CD could be considered within the literal language of the definition, not just the catch-all.

other federal banking regulatory agencies have jurisdiction, it will leave matters in their hands. It "follows" that the only CD that is definitely not a security is a CD issued by a federally insured bank that has not been traded in a secondary market.

The proposition that bank CDs are securities for purposes of the Investment Co. Act of 1940 (though not under the securities acts of 1933 and 1934), should be rejected. The basis for this argument is that the Investment Co. Act applies only to companies with more than 40% of their assets in securities. Investment Co. Act §3(a)(3), 15 U.S.C. 80a-3(a)(3). If CDs are not securities, money market funds (which hold approximately 22.9% of their assets in CDs) will be able to evade the Investment Co. Act by holding 40% of their assets in non-securities. This would be bad, explains the SG, because the relationship between a money market fund and its shareholders is identical to the relationship between an investment company and its shareholders.

The major problem with this argument is that Congress provided that the Investment Co. Act applies to an entity engaged in investing or reinvesting only if it "owns or proposes to acquire securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis." For other companies, the registration and disclosure provisions of the SEA apply. SEA §12(g)(2)(b), §78l(g)(2)(b). Given this definition of the scope of the Investment Co. Act, one suspects that Congress would not have wanted it to apply to money-market funds just because the relationship between their shareholders and the company is the same

as the relationship between the shareholders of other investment companies and their shareholders.

The distinction Congress regarded as determinative is the amount of a company's holdings in cash or cash-like holdings relative to its holdings in securities, with their higher risk. Congress did not include gov't securities and cash items (low risk items) as securities in determining whether 40% of a company's assets were securities. And CDs and other deposit instruments are usually regarded as essentially cash items, and, in terms of risk, are certainly more like cash than like securities. In effect, the SG is arguing for the removal of the 40% limit on the Investment Co. Act's applicability, substituting for it a new standard: the Act applies to any company whose relation with its shareholders is like that of an investment company.

In addition, it is most unlikely that Congress used the same definition of "security" in 1934 in the SEA and in 1940 in the Investment Co. Act, but meant different things.

The SG's qualification that CDs issued by non-federally regulated (as opposed to those of federally regulated) entities might be CDs is similarly unprincipled. There is certainly nothing in the legislative history or language of the statute to suggest that whether the issuer is a federally regulated entity is relevant to whether an item is a security. If Congress did not intend, as a general matter, to regulate all banks under the securities acts--and if it deliberately did not extend federal banking regulation to all banks--Congress presumably thought that the states themselves could manage to regulate their own banks. Congress' failure to regulate

certain entities under one statute should not, in itself, create a presumption that it meant to regulate them under another statute generally applicable to quite different entities and not applicable to similar entities subject to direct federal regulation.

Turning to the secondary market distinction, see n. 40 in SG's brief, the idea here seems to be that an interest that is not a security at the time of issue might become one in a subsequent transaction. In effect, the SG is trying to change the jurisdictional coverage of the securities acts from one determined by reference to the type of instrument to one determined by the identity of the seller on a transaction-by-transaction basis (not a security unless this seller is already subject to pervaisive federal regulation). This is a fairly radical rewriting of the securities acts, which, by their terms, apply to purchases and sales (and registration, etc.) of securities. Thus, the pledge of the CD to Marine Bank was not the pledge of a security; the CD was not a security when it was pledged because it was not a security when issued and nothing happened between issuance and pledge to change its nature.

B. The W-P Agreement

The question here is whether the W-P agreement is an investment agreement. As discussed in SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946), and other cases of this Court discussed above, the key question is whether there is an investment of money in a common enterprise with profits to come solely from the efforts of others. Here, in return for guaranteeing the loan, the Weavers

received the following: (1) use of the barn and pasture on the slaughterhouse premises; (2) 50% of the "adjusted net profits" of Columbus Packing so long as the Weavers remained co-obligors; (3) $100 a month until loan repaid; and (4) veto of any future loans to Columbus. The Weavers maintain that the Bank induced them to sign the pledge by telling them that the value of the Bank's collateral was sufficient to cover its interest and theirs and that there was little risk in the arrangement. See Brief of Weavers (red) n.10 at 7. On the other hand, Mr. Weaver testified that they intended to "invest" in Columbus and to receive "a little share in the business, if he made any profits; he was giving us a little share in his business if we'd loan him a little working capital." Id., at 17 n.18.

Two questions are presented by this issue. First, is the agreement an investment (and therefore a security)? Second, is it possible the Bank can be held liable for fraud in connection with the agreement, to which it was not a party and of which it knew nothing?

1. Is the agreement a security? There are several ways in which this aspect of the case could be disposed of. One would be to remand for further factual development on whether this was an investment. On the other hand, Judge Weis, dissenting below, noted that the Howey test, affirmed by this Court in Forman, requires "an investment of money in a common enterprise with profits to come solely from the efforts of others." Forman, 421 U.S., at 852 (emphasis added). Judge Weis noted that the Weaver's profits were not to come "solely" from the efforts of others since the "profits"

included the right to use the Piccirillo's pasture and barn. In addition, Judge Weis understood "common enterprise" as meaning something more than a face to face encounter between two individuals. When all the parties involved deal directly with each other, the transaction is simply not the type of market transaction the securities laws were designed to regulate. Judge Weis approved the CA7's requirement that a common enterprise must include both multiple investors and a pooling of their funds. See Hird v. Agri-Reasearch Council, Inc., 561 F. 2d 96, 100 (CA7 1977).[10] The issue of whether a unique agreement between two individuals can be a security seems to be just emerging, and there is little law on the point.

I find both of Judge Weis' points persuasive. The ability to use the land and barn suggests a transaction more like a lease than a true investment--the value of that ability would not depend on the efforts of others or the degree of success of the enterprise. To the extent the guarantee was in exchange for use of the land and barn, it was not an investment at all. In Howey and the other cases articulating the Howey rule with its "solely" requirement, the Court has indicated that a transaction must be solely an investment before

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[10] The CA7 position that a contract between with a "unitary nature" is not a security seems to have originated in Milnarid v. M-S Commodities, Inc., 457 F. 2d 274, 277 (CA7 1972) (Duffy, Kerner, & John Paul Stevens, Circuit Judges).

The American Law Institute's proposed code includes a provision that investment contracts are securities only if an offering or distribution has been made pursuant to an offering statement or distribution statement. American Law Institute, Federal Securities Code--Proposed Official Draft, at 158 (1978).

it will be considered a security.

On the second point, if an agreement between two individuals can be a security, rule 10b-5 may soon apply to all contracts in which one side can argue that it expects to receive the contracted-for benefit from the profits of the other party's enterprise. Individually-negotiated, unique, contracts are certainly not the types of arrangements Congress had in mind when it attemped to protect investors by regulating the securities markets.

This is likely

2. Can the Bank be held liable for fraud in connection with this second security? The Weavers themselves testified (in affidavits) that they did not tell the Bank about the W-P agreement. And various Bank officers testified (in affidavits) that they knew nothing about the agreement. The agreement was prepared by Piccirillo's attorney and delivered by the Piccirillos to the Weaver home, where the four of them negotiated certain changes and signed it. It is likely that the Bank did not know about the agreement.

The DC concluded that the Bank could not, therefore, be held liable on a secondary-liability theory for aidding and abetting (aidding and abetting fraud in connection with the sale fo this security) because it did not know of the "security." And the DC rejected the notion that the Bank could not be held liable for failure to disclose the debtor's status, noting that there was no such duty under state law.

But the Weavers did not just accuse the Bank of failure to disclose. They accused it of affirmative acts constituting fraud: that Bank officers lied to the Weavers about the status of Columbus.

There is, therefore, no need for an aidding and abetting theory. Moreover, even if the Bank did not know about the agreement, it must have known that the Weavers were getting something out of the deal. Given the opportunity to present their case in a trial (i.e., assuming the W-P agreement is a security), the Weavers might be able to show that the Bank knew, or should have known, that as a result of the Bank's fruadulent statements to the Weavers, the Weavers were purchasing some kind of security from the Picirillos. If such a showing were made, I do not see why the Bank should not be liable. If you consider the W-P agreement a security, it would be appropriate to remand for trial on whether the Bank can be held liable for the Weavers' loss.

C. The Pendant Claims

This case (viewing the facts most favorably to the Weavers) is really very sad. The Weavers argue that if federal courts do not consider their claims, they may be out of court. They explain that they filed an action in state court "by way of summons which was not served in reliance upon the federal court resolving the controversy. Any further prosecution of this claim in state court now may well be barred by a two year statute of limitations." Resp brief (red), at 42 n.30. I don't understand this at all. Why file something in state court in such a way that it does you no good? Moreover, at the time the DC dissmissed this action (Jan. 11, 1980), the 2-year statute had not run--the contract was signed Mar. 17, 1978. The Weavers' lawyers had over 2 months in which to file something effective in state court after it was clear that they might not get

anywhere in federal court (which they should have suspected from the beginning).

The CA remanded the pendant claims to the DC to consider whether they should be tried with the federal ones. This aspect of the CA's decision was not challenged in the cert petn, but if the Court holds that neither the CD nor the W-P agreement is a security, there is no point in remanding for the DC's consideration of only the pendant claims. In United Mine Workers v. Gibbs, 383 U.S. 715 (1966), the Court held that it was proper to consider state-law claims based on the same facts as a federal claim, but added that if the federal claim were is dismissed before trial, "certainly ... the state claims should be dismissed as well." If the remand consists only of the pendant claims, the DC will simply dismiss them automatically.

If either the CD or the W-P agreement is a security, there will be a remand for trial. In that event, the state-law claims should also be remanded for the DC to consider whehter they should be tried together with the federal claims, a question the DC did not address because it dismissed all the federal claims prior to trial.

CONCLUSION

The major question is whether a bank CD is a security within the meaning of that term in the SEA. The language of the statute, its legislative, and the decisions of this Court suggest that it is not. A security is an investment whereby an investor places his capital at the risk of an enterprise in the hope of profiting thereby solely from the skills and efforts of others. A

CD is simply a deposit of money in a bank for safekeeping, at a set interest rate, with minimal risk. Such deposits are subject to regulation under the Glass-Steagall Act, not the securities acts.

The next question is whether the W-P agreement is a security. I would argue that it is not a security because it is a unique, individually-negotiated agreement (a contract) between two individuals; as such it fails to meet the developing requirements for finding an intent to invest in a "common enterprise." Moreover, it is not a security because the Weavers received the right to use land and a barn, and did not, therefore, expect to profit solely from the efforts of others.

A holding that neither the CD nor W-P agreement is a security would be consistent with the ALI's proposed federal securities code.[11]

If you consider the W-P agreement a security, then it is necessary to consider whether it is possible that, at a trial, the Weavers could establish a basis for holding the Bank liable. Viewing the facts most favorably for the Weavors, a remand is

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[11]The American Law Institute has published a proposed official draft of a federal securitis code (Mar. 15, 1978). The definition of security is essentially the same as in the securities acts, but the proposal also includes a section excluding certain interests from the term. Most of the exclusions are the codification of caselaw. Securities do not include consumer or commercial loans or bank deposits or CDs. And certificates of interest, investment contracts, and fractional undivided interests in mineral rights are securities only if the "interest or instrument is of a class that was the subject of an offering statement or a distribution statement." American Law Institute, Federal securities Code--Proposed Official Draft, at 157-158 (1978).

appropriate because they might be able to show that the Bank deliberately mis-led them knowing (or under circumstances such that it should have known) that as a result, the Weavers would purchase some form of security from the borrowors.

If neither the agreement nor the CD is a security, there is no point (nor any harm) in remanding the pendant state claims to the trial court; it is settled law that if federal claims are dismissed prior to trial, pendent state claims should also be dismissed. If either the agreement or the CD is a security, however, it is appropriate to remand the pendent claims to the DC for its consideration of whether they should be tried with the federal claims.

80-1562 Marine Bk v Weaver 1/8/82

Two Qs:

I. Is a Bk. "CD" a "security" under Rule 10b-5 (§10b '34 Act). NO

all agencies agree on this

(a) It is not included in long list in definition section (§ 3(a)(10)).
(b) Leg. history shows Congress intended to regulate Banks separately.
(Regulatory Agencies have vascillated but now agree - not a security)

(c) Does not possess key attributes of a security. SEC v Howey; Forman

It is essentially a bank a/c certificate

Is not an investment in a "common venture" motivated by expectation of profit.
(No right to vote. - but neither does a bond holder)

II. Is a discrete (unique) ctt. between between two parties an "investment agt"? NO

I agree with J. Marr's dissent. Of course the agreement here - unique on its facts - is a "security"; as a vast number of business ctts will come under Act. (Sad case!)

File

meb 01/11/82

Altho I'll listen to discussion, I am not enthusiastic for retaining pendent state claims when, as here, the fed claims seem so marginal that DC dismissed them. (Of course CA3 sustained them.) Moreover, there was an opportunity to file state law fraud case & Rapko's counsel failed to do so. Statute of Lims. had not run.

To: Mr. Justice Powell

From: Mary

In re: No. 80-1562, Marine Bank v. Samuel and Alice Weaver

This memo (1) explains that the Court might consider it appropriate for the DC to hear the pendent claims even if the federal claims are dismissed (contrary to the bench memo); and (2) a clarification of the SG's position (petr confused this point at oral argument.

1. Pendent claims. In the bench memo, I stated that it is settled law that when federal claims are dismissed prior to trial, pendent claims should also be dismissed, citing United Mine Workers v. Gibbs, 383 U.,S. 715 (1966). In Gibbs, the Court stated that when federal claims are dismissed prior to trial, pendent state claims "should be dismissed as well." But the Court was not considering a case in which pendent state could no longer be brought in state court.

In Rosado v. Wyman, 397 U.S. 397 (1970), a three-judge court was convened to hear a federal constitutional claim and a pendent federal statutory claim. Prior to a decision, but after some hearings and argument, the federal constitutional claim was mooted. The question therefore arose as to whether the three-judge court had jurisdiction over the pendent federal statutory claim.

The resps (in Rosado) argued that Gibbs was controlling and that the pendent claim should have been dismissed because the claim conferring jurisdiction on the three-judge court had been dismissed before trial. The Court did not agree, distinguishing Gibbs on the ground that there, the Court was discussing an insubstantial jurisdiction-conferring claim whereas in Rosado, the Court was considering the mooting of a claim. The Court noted that "[u]nlike insubstantiality, which is apparent at the outset, mootness, frequently a matter beyond the control of the parties, may not occur until after substantial time and energy have been expended looking toward the resolution of a dispute that plaintiffs were entitled to bring in federal court." Id., at 404. The Court did not expressly overrule the Gibbs dicta, however:

> "Whether or not the view that an insubstantial federal question does not confer jurisdiction--a maxim more ancient than analytically sound--should now be held to mean that a district court should be considered without discretion, as opposed to power, to hear a pendent claim, we think the respondents' analogy [from Gibbs to this case] fails."

Thus, the Court explicitly rejected the analogy to Gibbs, rather than overruling it, though it did express doubt that a DC would lack the power to hear pendent state claims.

After Rosado, a strong argument can be made that a DC has jusrisdiction to consider state claims pendent to federal claims, even federal claims dismissed prior to trial, and that this jurisdiction should be exercised in appropiate instances to serve the purposes of judicial efficiency and equity.

On March 17, 1978, the Weavers pledged their CD to the Bank and the Bank loaned Columbus $65,000. On May 4, 1979, the complaint

was filed with the DC. The action was dismissed for lack of any federal question on Jan. 11, 1980. At that time, the 1-year Pa. statute of limitations for the state security-act claim (mentioned for the first time at oral argument) barred the state security-act claim. There was still over two months in which to file the state common law-fraud claim.

At oral argument, resps argued that the dismissal was on the eve of trial and, given the possible statute of limitation problem, equity supports the exercise of jurisdiction by the DC.

I find this case a close one. Provided there is a substantial federal claim at the time a complaint is filed, the better rule would seem to be a DC has jurisdiction to consider pendent claims even if the federal claim is dismissed prior to trial. Whether to exercise such jurisdiction would be a matter committed to the discretion of the DC and would depend on the amount of judicial resources already expended and the equities of the situation (e.g., if the deft was on notice of the claims in the federal action and the state statute of limitiations has run at time federal claim is dismissed, the equities suggest that the DC retain jurisdiction unless the deft is willing to waive the statute of limitations in the state court proceeding).

In this case, the federal claim was not obviously insubstantial in the sense that it was clear that there really was no federal claim when the action was filed. Thus, for example, if the DC had gone ahead and tried the claims and then dismissed the federal claim, it is clear that there was a substantial-enough claim under Gibbs to support the exercise of jurisdiction over the state-

law claims. Whether to exercise jurisdiction given that the federal claim was dismissed prior to trial should turn, therefore, on the judicial resources already expended and the equitites of the situtation. At the time the case was dismissed, there had already been discovery, the submission of pretrial narrative statements, and a pre-trial conference. It may be that much of this effort would have to be duplicated were the state law claims tried in state court. Moreover, at the time of dismissal, according to the oral argument, the state-security law claim was time-barred. On the other hand, the common law-fraud count was not time-barred, and resps nevertheless made no attempt to file an effective fraud claim in state court.

The DC will be in a better position to judge these factors than is this Court--especially the extent to which judicial rescources have been expended and will be conserved by proceeding with the state-law counts in federal court. The question is not even technically before the Court; as the case now stands, the state-law counts have been remanded to the DC for its determination of whether it should procede with them. Cert was not granted on the propriety of that remand. This is the proper solution, though the Court might mention in the decision that the DC was being given the opportunity to consider whether, under Rosado, it should consider the claims.

2. The SG's position. The Bank's lawyer maintained that the SG had not conceded that all CDs issued by federally-insured banks are securities, but he was unable to point to a particular

part of the SG's brief to illustrate his point. The lawyer thought that the SG had reserved the question of how the regulators would treat CDs of federally-insured banks traded in a secondary market. He was right. This reservation is in the SG's brief, n.40 at 24:

> "Another situation that may present a different context is the trading of certificates of deposit in the secondary market, a circumstance that is not presented in this case."

I have never been sure what the SG meant by this. The CD here was traded after issue. For purposes of the securities law, a pledge is a sale, and the Weavers did, therefore, trade the CD for the W-P agreement in a secondary (post-issue) transaction. Perhaps the SG only reserves the question in instances in which there is a more formal "market," but, if so, he gives no guidance as to what factors he considers relevant in distinguishing between this secondary sale and a transaction in a secondary market. But that question not presented

80-1562 MARINE BANK v. WEAVER Argued 1/11/82

What constitutes a "security"? CA 3 held that both CD and a ctt. bet. two partners are partners.

The ctt. was made bet. two local men hoping to profit from the cattle business. No pooling of funds by investors. (What is dep. bet their & the customary ctt between leasing of a farm with owner & lessee to share in profit from ~~crops~~ crops).

Miller (For Peter. Banks)

Argued only 10 minutes

Conner (For Resps who traded their CD for an investment in the failing business)

Bank persuaded Resps to bail out the Bank. It was a fraud.

Not complaining about original issue of CD – only the secondary transaction. This distinguishes many of the cases.

(SEC + Banking Agencies agree that neither the CD nor the CP was a security)

Reverse

No. 80-1562, Marine Bank v. Weaver Conf. 1/13/82

The Chief Justice Reverse on both.

Justice Brennan Reverse & Affirm

CD clearly not a "security."

The contract, however, is different.

Would affirm on remand

Justice White Reverse on both

Write narrowly

Justice Marshall

Absent on first vote

Justice Blackmun ~~Rev.~~ Rev. on both

Justice Powell Reverse - as to both issues

Neither a DC, nor a privately negotiated ctt. between two persons to undertake a business venture, is a "security" under the Fed Acts.

There was fraud by Bank, & state remedies were available.

Justice Rehnquist Rev - both

Write narrowly

Justice Stevens Rev. on both

But agree with SG that as to ctt, should write narrowly

Leave open pendent juris issue - not for us to decide.

Justice O'Connor Rev on both.

Write narrowly

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE SANDRA DAY O'CONNOR

March 1, 1982

No. 80-1562 Marine Bank v. Weaver

Dear Chief,

Please join me in your opinion in the referenced case.

Sincerely,

Sandra

The Chief Justice

Copies to the Conference

To: Justice Brennan
Justice White
Justice Marshall
Justice Blackmun
Justice Powell
Justice Rehnquist
Justice Stevens
Justice O'Connor

From: The Chief Justice

Circulated: MAR 1 1982

Recirculated: 3/2

FIRST DRAFT

SUPREME COURT OF THE UNITED STATES

No. 80-1562

MARINE BANK, PETITIONER *v.*
SAMUEL WEAVER, ET UX.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

[February ——, 1982]

CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to decide whether two instruments, a conventional certificate of deposit and a business agreement between two families, could be considered securities under the antifraud provisions of the federal securities laws.

I

Respondents, Sam and Alice Weaver, purchased a $50,000 certificate of deposit from petitioner, Marine Bank, on February 28, 1978. The certificate of deposit has a six year maturity and it is insured by the Federal Deposit Insurance Corporation.[1] The Weavers subsequently pledged the certificate of deposit to Marine Bank on March 17, 1978, to guarantee a $65,000 loan made by the Bank to Columbus Packing Company. Columbus was a wholesale slaughterhouse and

[1] The certificate of deposit pays 7½% interest and provides that, if the Bank permits early withdrawal, the depositor will earn interest at the Bank's current savings passbook rate on the amount withdrawn, except that no interest will be paid for the three months prior to withdrawal. When the Weavers purchased the certificate of deposit, it could only be insured up to $40,000 by the FDIC. The ceiling on insured deposits is now $100,000. Act of March 31, 1980, Pub. L. No. 96-221, 94 Stat. 147, § 308(b)(1).

retail meat market which owed the Bank $33,000 at that time for prior loans and was also substantially overdrawn on its checking account with the Bank.

In consideration for guaranteeing the Bank's new loan, Columbus' owners, Raymond and Barbara Piccirillos, entered into an agreement with the Weavers. Under the terms of the agreement, the Weavers were to receive 50% of Columbus' net profits and $100 per month as long as they guaranteed the loan. It was also agreed that the Weavers could use Columbus' barn and pasture at the discretion of the Piccirillos, and that they had the right to veto future borrowing by Columbus.

The Weavers allege that Bank officers told them Columbus would use the $65,000 loan as working capital but instead it was immediately applied to pay Columbus' overdue obligations. The Bank kept approximately $42,800 to satisfy its prior loans and Columbus' overdrawn checking account. All but $3,800 of the remainder was disbursed to pay overdue taxes and to satisfy other creditors; the Bank then refused to permit Columbus to overdraw its checking account. Columbus became bankrupt four months later. Although the Bank had not yet resorted to the Weavers' certificate of deposit at the time this litigation commenced, it acknowledged that its other security was inadequate and that it intended to claim the pledged certificate of deposit.

These allegations were asserted in a complaint filed in Federal District Court for the Western District of Pennsylvania in support of a claim that the Bank violated § 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b). The Weavers also pleaded pendent claims for violations of the Pennsylvania Securities Act and for common law fraud by the Bank. The Weavers alleged that Bank officers actively solicited them to guarantee the $65,000 loan to Columbus while knowing, but not disclosing, Columbus' financial plight or the Bank's plans to repay itself from the new loan guaranteed by the Weavers' pledged certificate of deposit. Had they known of Columbus' precarious financial condition and the

Bank's plans, the Weavers allege they would not have guaranteed the loan and pledged the certificate of deposit. The District Court granted summary judgment in favor of the Bank. It concluded that if a wrong occurred it did not take place "in connection with the purchase or sale of any security," as required for liability under § 10(b). The District Court declined to exercise pendent jurisdiction over the state law claims.

The Third Circuit Court of Appeals reversed. *Weaver* v. *Marine Bank*, 637 F. 2d 157 (CA3 1980). A divided court held that a finder of fact could reasonably conclude that either the certificate of deposit or the agreement between the Weavers and the Piccirillos was a security.[2] It therefore remanded for further consideration of the claim based on the federal securities laws. The Court of Appeals also reversed the District Court's dismissal of the pendent state law claims.

We granted certiorari, —— U. S. —— (1981), and we reverse. We hold that neither the certificate of deposit nor the agreement between the Weavers and the Piccirillos is a security under the antifraud provisions of the federal securities laws. We remand the case to the Court of Appeals to determine whether the pendent state claims should be dismissed.

II

The definition of security in the Securities Exchange Act of 1934[3] is quite broad. The Act was adopted to restore inves-

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[2] The Court of Appeals also concluded that the pledge of a security is a sale, an issue on which the federal circuits were split. We held in *Rubin* v. *United States*, —— U. S. —— (1981), that a pledge of stock is equivalent to a sale for the purposes of the antifraud provisions of the federal securities laws. Accordingly, in determining whether fraud may have occurred here "in connection with the purchase or sale of any security," the only issue now before the Court is whether a *security* was involved.

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

"(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 agree-

tors' confidence in the financial markets,[4] and the term security was meant to include "the many types of instruments that in our commercial world fall within the ordinary concept of a security." H.R. Rep. No. 85, 73d Cong., 1st Sess., 11 (1933); quoted in *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 849–850 (1975). The statutory definition excludes only currency and notes with a maturity of less than nine months. It includes ordinary stocks and bonds, along with the "countless and variable schemes devised by those who seek the use of the money of others on the promise of profits . . . ." *SEC* v. *W.J. Howey, Inc.*, 328 U. S. 293, 299 (1946). Thus, the coverage of the antifraud provisions of the securities laws is not limited to instruments traded at securities exchanges and over-the-counter markets, but extends to uncommon and irregular instruments. *Superintendent of Insurance* v. *Bankers Life & Casualty Co.* 404 U. S. 6, 10 (1971); *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U. S. 344, 351 (1943). We have repeatedly held that the test "is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the

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ment or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization 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 time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity is likewise limited."

We have consistently held that the definition of security in the 1934 Act is essentially the same as the definition of security in § 2(1) of the Securities Act of 1933, 15 U. S. C. § 77(b)(1). *United Housing Foundation, Inc.* v. *Forman*, 421 U. S. 837, 847 n. 12 (1975).

[4] Fitzgibbon, *What is a Security? A Redefinition Based on Eligibility to Participate in the Financial Markets*, 64 Minn. L. Rev. 893, 912–918 (1980).

economic inducements held out to the prospect." *SEC* v. *United Benefit Life Insurance Co.*, 387 U. S. 202, 211 (1967), quoting *SEC* v. *C.M. Joiner Leasing Corp.*, *supra*, 320 U. S., at 352–353.

The broad statutory definition is preceded, however, by the statement that the terms mentioned are not to be considered securities if "the context otherwise requires . . . ." Moreover, we are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for fraud. *Great Western Bank & Trust* v. *Kotz*, 532 F. 2d 1252, 1253 (CA9 1976); *Bellah* v. *First National Bank*, 495 F. 2d 1109, 1114 (CA5 1974).

III

The Court of Appeals concluded that the certificate of deposit purchased by the Weavers might be a security. Examining the statutory definition, *supra*, n. 3, the court correctly noted that the certificate of deposit is not expressly excluded from the definition since it is not currency and it has a maturity exceeding nine months.[5] It concluded, however, that the certificate of deposit was the functional equivalent of the withdrawable capital shares of a savings and loan association held to be securities in *Tcherepnin* v. *Knight*, 389 U. S. 332 (1967). The court also reasoned that, from an investor's standpoint, a certificate of deposit is no different from any other long-term debt obligation.[6] Unless distinguishing fea-

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[5]The definition of a security in the 1934 Act, *supra*, n. 4, includes the term, "certificate of deposit, for a security." However, this term does not refer to certificates of deposit such as the Weavers purchased. Instead, "certificate of deposit, for a security" refers to instruments issued by protective committees in the course of corporate reorganizations. *Canadian Imperial Bank of Commerce* v. *Fingland*, 615 F. 2d 465, 468 (CA7 1980).

[6]In addition, the Court of Appeals noted that the Securities and Exchange Commission had taken the position that certificates of deposit are securities. However, the SEC has filed a brief as *amicus curiae* in this case, jointly with the Federal Deposit Insurance Corporation, the Board of

tures were found on remand, the court concluded that the certificate of deposit should be held to be a security.

Tcherepnin is not controlling. The withdrawable capital shares found there to be securities did not pay a fixed rate of interest; instead, purchasers received dividends based on the association's profits. Purchasers also received voting rights. In short, the withdrawable capital shares in *Tcherepnin* were much more like ordinary shares of stock and "the ordinary concept of a security," *ante*, at 4, than a certificate of deposit.

The Court of Appeals' also concluded that a certificate of deposit is similar to any other long-term debt obligation commonly found to be a security. In our view, however, there is an important difference between a bank certificate of deposit and other long-term debt obligations. This certificate of deposit was issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry.[7] Deposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising relating to the interest paid on deposits is also regulated.[8] In addi-

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Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency, which argues that the Weavers' certificate of deposit is not a security.

[7] In *International Brotherhood of Teamsters* v. *Daniel*, 439 U. S. 551 (1979), we held that a noncontributory, compulsory pension plan was not a security. One of our reasons for our holding in *Daniel* was that the pension plan was regulated by the Employee Retirement Income Security Act of 1974 (ERISA): "The existence of this comprehensive legislation governing the use and terms of employee plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans." 439 U. S., at 569–570. Since ERISA regulates the substantive terms of pension plans, and also requires certain disclosures, it was unnecessary to subject pension plans to the requirements of the federal securities laws as well.

[8] See, *e. g.* 12 U. S. C. § 461(b) (reserve requirements); 12 U. S. C. (and Supp. III) §§ 161, 324, and 1817 (reporting requirements); 12 U. S. C. (and Supp. III) §§ 481, 483, and 1820(b) (inspection requirements); 12 CFR

tion, deposits are insured by the Federal Deposit Insurance Corporation. Since its formation in 1933, nearly all depositors in failing banks insured by the FDIC have received payment in full, even payment for the portions of their deposits above the amount insured. *1980 Annual Report of the Federal Deposit Insurance Corporation* 18–21 (1981).

We see, therefore, important differences between a certificate of deposit purchased from a federally regulated bank and other long-term debt obligations. The Court of Appeals failed to give appropriate weight to the important fact that 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. The definition of security in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws. We therefore hold that the certificate of deposit purchased by the Weavers is not a security.[9]

IV

The Court of Appeals also held that a finder of fact could conclude that the separate agreement between the Weavers and the Piccirillos is a security. Examining the statutory language, *supra*, n. 3, the court found that the agreement might be a "certificate of interest or participation in any profit-sharing agreement" or an "investment contract." It stressed that the agreement gave the Weavers a share in the

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§§ 217.6 and 329.8 (advertising).

[9]We reject respondents' argument that the certificate of deposit was somehow transformed into a security when it was pledged, even though it was not a security when purchased.

profits of the slaughterhouse which would result from the efforts of the Piccirillos. Accordingly, in that court's view, the agreement fell within the definition of investment contract stated in *Howey*, because "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U. S., at 301.

Congress intended the securities laws to cover those instruments ordinarily and commonly considered to be securities in the commercial world, but the agreement between the Weavers and the Piccirillos is not the type of instrument that comes to mind when the term security is used and does not fall within "the ordinary concept of a security." *Ante*, at 4. The unusual instruments found to constitute securities in prior cases involved offers to a number of potential investors, not a private transaction as in this case. In *Howey*, for example, 42 persons purchased interests in a citrus grove during a four-month period. 328 U. S., at 295. In *C.M. Joiner Leasing*, offers to sell oil leases were sent to over 1,000 prospects. 320 U. S., at 346. In *C.M. Joiner Leasing*, we noted that a security is an instrument in which there is "common trading." *Id.*, at 351. The instruments involved in *C.M. Joiner Leasing* and *Howey* had equivalent values to most persons and could have been traded publicly.

Here, in contrast, the Piccirillos distributed no prospectus to the Weavers or to other potential investors, and the unique agreement they negotiated was not designed to be traded publicly. The provision that the Weavers could use the barn and pastures of the slaughterhouse at the discretion of the Piccirillos underscores the unique character of the transaction. Similarly, the provision that the Weavers could veto future loans gave them a measure of control over the operation of the slaughterhouse not characteristic of a security. Although the agreement gave the Weavers a share of the Piccirillos' profits, if any, that provision alone is not sufficient to make that agreement a security. Accordingly, we hold

that this unique agreement, negotiated one-on-one by the parties, is not a security.[10]

V

The Weavers allege that the Bank manipulated them so that they would suffer the loss the Bank would have borne from the failure of the Columbus Packing Company. Whatever claims they may have against the Bank are not before the Court since the Court of Appeals did not treat the issue of the pendent state law claims. Accordingly, the case is remanded for consideration of whether the District Court should now entertain those claims.

Reversed and remanded.

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[10] *Cf. Kotz, supra*, 532 F. 2d, at 1260–1062 (Kennedy, J., concurring) (unsecured note, the terms of which were negotiated face-to-face, given to a bank in return for a business loan, is not a security).

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WILLIAM H. REHNQUIST

March 2, 1982

Re: No. 80-1562 Marine Bank v. Weaver

Dear Chief:

Please join me in your opinion for the Court.

Sincerely,

WHR

The Chief Justice

Copies to the Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE WM. J. BRENNAN, JR.

March 2, 1982

RE: No. 80-1562 Marine Bank v. Weaver

Dear Chief:

I join.

Sincerely,

The Chief Justice

cc: The Conference

March 2, 1982

80-1562 Marine Bank v. Weaver

Dear Chief:

Please join me.

Sincerely,

The Chief Justice

lfp/ss

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE BYRON R. WHITE

March 3, 1982

Re: 80-1562 - Marine Bank v. Weaver

Dear Chief,

Please join me.

Sincerely yours,

Byron

The Chief Justice

Copies to the Conference

cpm

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE THURGOOD MARSHALL

March 3, 1982

Re: No. 80-1562 - Marine Bank v. Weaver

Dear Chief:

Please join me.

Sincerely,

T.M.

The Chief Justice

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE HARRY A. BLACKMUN

March 3, 1982

Re: No. 80-1562 - Marine Bank v. Weaver

Dear Chief:

Please join me.

Sincerely,

HAB.

The Chief Justice

cc: The Conference

Supreme Court of the United States
Washington, D. C. 20543

CHAMBERS OF
JUSTICE JOHN PAUL STEVENS

March 5, 1982

Re: 80-1562 - Marine Bank v. Weaver

Dear Chief:

Please join me.

Respectfully,

The Chief Justice

Copies to the Conference

THE C. J.	W. J. B.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.	J. P. S.	S. D. O'C.
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				80-1562 Marine Bank v. Weaver				