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Share Accounts in Savings and Loan Associations -- Securities Within the Securities Exchange Act of 1934

Gary S. Barber

COMMENTS

SHARE ACCOUNTS IN SAVINGS AND LOAN ASSOCIATIONS—SECURITIES WITHIN THE SECURITIES EXCHANGE ACT OF 1934

GARY S. BARBER*

I. INTRODUCTION

The recent decision of *Tcherepnin v. Knight*,[1] a case of first impression, held that a share account, or a withdrawable capital account in an Illinois chartered savings and loan association was not a "security" within the provisions of the Securities Exchange Act of 1934.[2]

This decision arose out of an action brought by the plaintiffs against City Savings Association, an Illinois chartered savings and loan association which was undergoing voluntary liquidation and was in the custody of the defendant, Director of Financial Institutions of the State of Illinois.

In their complaint, plaintiffs described themselves as purchasers of securities issued by City Savings, consisting of capital shares and a capital interest in City Savings. The plaintiffs further alleged that in acquiring the above-described interests they had relied on false and misleading solicitations mailed to them in violation of section 10(b) of the Securities Exchange Act of 1934[3] and of the general rules and regulations promulgated thereunder.[4]

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* Member Editorial Board, University of Miami Law Review

1. 371 F.2d 374 (7th Cir. 1967), *cert. granted*, 87 S. Ct. 2076 (1967).

2. 15 U.S.C. § 78a (1964) [hereinafter referred to as the 1934 act].

3. 15 U.S.C. § 78j(b) (1964). This section provides:

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

. . . .

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

4. Section 10b although broad in its terms is not self-executing, pursuant to the con-

Jurisdiction was invoked under section 27 of the 1934 act[5] and the plaintiffs sought to have their purchases declared void pursuant to section 29(b)[6] of the Act entitling them to rescind their investments and recover the amount of their investments plus interest.[7]

The defendant, City Savings, and the three liquidators moved to dismiss the complaint for lack of jurisdiction, contending that the share accounts involved were not securities within the meaning of the 1934 act. This motion was denied by the district court.

The question presented by denial of this motion to dismiss was certified by the district court.[8] Petition for leave to file interlocutory appeal was granted.

The court of appeals concluded that the interests involved were not within the definition of a "security" under the 1934 act, and that therefore the anti-fraud provisions of that act were not applicable and the district court lacked jurisdiction. The decision of the district court was reversed and the cause remanded with instructions to dismiss the complaint.

The significance and effect of this decision cannot be overemphasized. At the conclusion of the majority opinion the sighs of relief by the already heavily regulated savings and loan industry were almost audible.[9]

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gressional delegation of authority contained in section 10b, on May 21, 1942, the SEC adopted rule 10b-5, 17 C.F.R. § 240.106-5 (1949), which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of any facility or any national securities exchange,
>
> (1) to employ any device, scheme or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

5. 15 U.S.C. § 78aa (1964).

6. 15 U.S.C. § 78cc (1964).

7. The general rule at common law is that one who has been induced to subscribe to shares in a savings and loan association by fraudulent representations as to its financial condition cannot, after the association becomes insolvent and is in the hands of receivers, rescind his contract and recover the amount which he had deposited or invested. Rummens v. Home Sav. & Loan Ass'n 182 Wash. 539, 47 P.2d 845, 100 A.L.R. 570 (1935); *See* Dunn v. Candee, 98 App. Div. 317, 90 N.Y.S. 674 (1904).

8. 28 U.S.C. § 1292(b) (1964).

9. The scope and sheer volume of rules and regulations to which the savings and loan associations are subject prompted this comment from a former member of the Federal Home Loan Bank Board:

> Without question, the savings and loan business is the most regulated of any industry, financial or otherwise in the United States today. In the future, restraint should be used by the industry and by Government in the shape and amount of regulation imposed on savings institutions . . . . Regulations and government control, when unduly accentuated tend to generate weakness rather than strength in management. They tend to distort normal business judgment in compliance with technical requirements rather than to business dictates . . . .

Prather & Weeks, *Savings and Loan Legislation—1965*, 21 BUS. LAW. 739 (1966).

On the other hand, the decision denies to share account holders the relief afforded by the anti-fraud provisions of the Securities and Exchange Act of 1934.[10]

II. THE NATURE OF A SAVINGS AND LOAN ASSOCIATION "SHARE ACCOUNT"

Generally, when money is deposited in a commercial bank, title passes to the bank. The bank becomes the debtor of the depositor to the extent of the deposit, and to that extent the depositor becomes the creditor of the bank.[11] Similarly, the relationship of debtor and creditor exists between a mutual savings bank and a depositor.[12]

The holder of a share account in a savings and loan association is not a creditor of the association, but a shareholder.[13] The relationship of a shareholder to a savings and loan association is analogous to the relationship between a shareholder and a corporation. Income paid on share accounts is not interest but dividends.[14] Share account holders elect the directors of the association,[15] they have the right to inspect certain records[16] and they have a right to receive dividends.[17] Holders of share accounts are subject to pro-rata liability for losses of the association,[18] and share proportionately in the association's property upon the winding up of the association.[19] Like a shareholder in a corporation, holders of share accounts occupy a subordinate position to the claims of general creditors.[20]

III. LEGISLATIVE FRAMEWORK

Both the Securities Act of 1933[21] and the Securities Exchange Act of 1934[22] contain provisions which define the term "security" in detail.

10. Since the Illinois statutory provisions regarding share accounts are typical and do not deviate materially from similar legislation in other states and on the federal level, the decision in *Tcherepnin v. Knight* would be equally applicable to share accounts in all "non-stock" savings and loan associations.

11. W. HAWKLAND, COMMERCIAL PAPER AND BANK DEPOSITS AND COLLECTIONS 276 (1967).

12. GARCIA, ENCYCLOPEDIA OF BANKING AND FINANCE 665 (6th ed. 1961).

13. Aetna Cas. & Sur. Co. v. Porter 296 F.2d 389 (D.C. Cir. 1961), *rev'd on other grounds*, 370 U.S. 159 (1961); Wisconsin Bankers' Ass'n v. Robertson, 294 F.2d 714 (D.C. Cir. 1961) *cert. denied*, 368 U.S. 938 (1961); ILL. REV. STAT. ch. 32 § 773(F) 1965 (the Illinois Savings & Loan Act) provides: "The holder of withdrawable capital for which application for withdrawal has been made, does not become a creditor by reason of such application." *But see* Protective Comm. v. Stewart, 241 Md. 89, 215 A.2d 726 (1966); Family Sav. & Loan Ass'n v. Stewart, 232 Md. 424, 194 A.2d 118 (1963).

14. GARCIA, *supra* note 12, at 66. *See also* FLA. STAT. § 665.29 (1965).

15. FLA. STAT. § 665.11 (1965); ILL. REV. STAT. ch. 32 § 742 (1965); GARCIA, *supra* note 12.

16. FLA. STAT. § 665.30 (1965); ILL REV STAT. ch. 32 § 748 (1965).

17. FLA. STAT. § 665.29 (1966); ILL. REV. STAT. ch. 32 § 780 (1965).

18. FLA. STAT. § 665.32 (1965).

19. FLA. STAT. § 665.19 (1965); ILL. REV. STAT. ch. 32 § 908 (1965).

20. FLA. STAT. § 665.19 (1965).

21. 15 U.S.C. 77a (1964) [hereinafter referred to as the 1933 act].

22. *See* note 2 *supra*.

Any question concerning the applicability of these two acts must begin with these provisions. Since the acts are in *pari materia*[23] an analysis of the definition sections of both acts is appropriate.

The 1934 Act defines securities as:

> [a]ny 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, 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 time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.[24]

The definition of a "security" contained in the 1933 act[25] is with one minor exception identical to that given in the 1934 act.[26] The one difference is that the 1933 act contains the term "evidence of indebtedness"[27] while the 1934 Act does not. Both acts clearly manifest an intent on the part of Congress to give the term "security" a broad and liberal meaning, as opposed to a strict and technical definition.[28]

Admittedly, neither the 1933 nor the 1934 Act specifically includes within its definition of a security share accounts in savings and loan associations. However, the 1933 Act specifically exempts such interests from the registration provisions of the Act.[29] It further provides that this exemption is not applicable to the anti-fraud provisions of the Act.[30]

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23. Rosenberg v. Globe Aircraft Corp., 80 F. Supp. 123 (E.D. Pa. 1948).

24. 15 U.S.C. § 78c(a)(10) (1964).

25. 15 U.S.C. § 77b (1) (1964).

26. The Senate report on the 1934 act observed that its definition of a security was substantially the same as that in the 1933 act. S. REP. No. 792, 73d Cong., 2d Sess. 14 (1934).

27. 15 U.S.C. § 77b(1) (1964).

28. "The term 'security' is defined in sufficiently broad and liberal terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of security." H.R. REP. No. 85, 73d Cong., 1st Sess. 11 (1933). "The Securities Act of 1933 describes 'security' very much more broadly than had been the previous interpretation of that term." SEC v. Starmont, 31 F. Supp. 264, 266 (E.D. Wash. 1940).

29. 15 U.S.C. § 77c (1964) provides in pertinent part:

> Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities:
>
> . . . .
>
> (5) Any security issued by a building and loan association, homestead association, savings and loan association, or similar institution, substantially all the business of which is confined to the making of loans to members . . . .

30. 15 U.S.C. § 77g(c) (1964).

Similarly, in 1964, in amending the 1934 Act by providing for the registration of equity securities by certain issuers, Congress exempted "any security . . . issued by a savings and loan association" from the new registration provisions.[31] It should be noted that this exemption in no way affects the applicability of section 10b of the Act or of rule 10-b5 promulgated by the Securities and Exchange Commission pursuant to that section.[32]

The legislative history of the 1933 and 1934 Acts contains very little comment regarding the applicability of these proposals to savings and loan associations. Lobbyists for the industry vigorously sought exemption from the registration provisions of the 1933 Act. On the other hand, Morton Bodfish, spokesman for these representatives, supported the application of the anti-fraud provisions of the statute to the issuance of savings and loan shares, which he described as securities.[33]

There was very little discussion of the definition of securities when the 1934 Act was under consideration by Congress.[34] However, in hearings on the 1964 amendments to the Act the then Chairman of the Securities and Exchange Commission, William J. Cory, observed in commenting on the exemption provisions:

> Because of the fact that most savings and loan associations issue so-called shares, which in fact merely evidence the existence of a savings account, special provisions had to be made to exempt that type of "share."[35]

The above-described provisions of the Securities Act of 1933 and the Securities and Exchange Act of 1934 do not establish clearly that a share account is or is not security. But the provisions should be liberally construed in the light of their purpose to protect investors.[36] The exemption of securities issued by savings and loan associations from the registration provisions of both acts certainly indicates that Congress understood such interests to be within the term "security" as defined by the acts. It also illustrates that when Congress desired to exclude savings and loan share accounts they knew how to do so in a specific manner without relying on vague implications.

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31. 15 U.S.C. § 78l(g)(2)(C) (1964).

32. Both section 10b, 15 U.S.C. § 78j(b) (1964), and rule 10b-5, 17 C.F.R. § 240.10b-5 (1949), are by their terms applicable to "any security."

33. *Hearings on H.R. 4314 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess., 72-74 (1933). *See also Hearings on S. 875 Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess., 50-54 (1933); RICHARDS, THE FEDERAL SECURITIES ACT, BUILDING AND LOAN ANNALS (1933) at 111, 115-118.

34. *See* note 26 *supra*.

35. *Hearings on H.R. 6789, H.R. 6793 and S. 1642 Before a Subcomm. of the House Comm. on Interstate and Foreign Commerce*, 88th Cong., 1st Sess., 1213 (1963).

36. SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344 (1943); SEC v. W. J. Howey Co., 328 U.S. 293 (1946); SEC v. Variable Annuity Life Ins. Co., 359 U.S. 65 (1959).

The majority opinion attributed these exemptions to an overabundance of caution on the part of Congress, and found the exemption of ordinary insurance policies to be analogous.[37] The court reasoned that despite the negative implication created by exemption there is general agreement that insurance policies are not securities.[38] They then applied this same reasoning to share accounts and arrived at a similar conclusion.[39] In reaching this conclusion the majority ignored some elements which might distinguish share accounts from ordinary insurance policies.

In the first place, unlike share accounts, insurance policies possess none of the attributes of a security.[40] Secondly, the legislative history of the 1933 Act clearly indicates that Congress did not intend for such interests to be covered by the legislation.[41] Thirdly, by concentrating on insurance policies the court failed to consider several types of securities which are exempted from the registration but which are, nevertheless, subject to the anti-fraud provisions.[42]

Finally, it should be noted that since the *Tcherepnin* decision the Supreme Court's decision in *SEC v. United Benefit Life Ins. Co.*[43] has placed some limitations on the exemption of insurance devices from the registration provisions of the 1933 Act, particularly when the appeal to the purchaser is on the basis of growth and investment as compared to the prospect of stability and security.

As indicated previously, the definition of a security in the 1933 Act was adopted by Congress in the 1934 Act with one minor exception. In the majority decision the court seized upon this difference and reasoned that the term "evidence of indebtedness" was excluded so as to totally exempt share accounts from the 1934 Act.[44] In this regard the court's reasoning is at best tenuous. The committee hearings on the 1934 act contain no indication that this was the intent of Congress. In addition, the subsequent exemption of securities issued by savings and loan associations from the registration provisions of the 1964 amendments[45] strongly indicate that Congress considered share accounts not to have been taken out of the Act by deletion of the term "evidence of indebtedness."

In his strong dissent, Judge Cummings suggests a rational basis for the deletion of evidence of indebtedness. Both Acts specifically exempt short term commercial paper from the definition of security.[46] By includ-

37. 15 U.S.C. § 77c(a)(8) (1964).
38. *See* 1 L. Loss, SECURITIES REGULATION 496-97 (2d ed. 1961).
39. Tcherepnin v. Knight, 371 F.2d 374, 378 (7th Cir. 1967).
40. *See* text *supra*, pp. 397.
41. 1 L. Loss, *supra* note 38.
42. 15 U.S.C. § 77c(a) (1964).
43. 387 U.S. 202 (1967).
44. 371 F.2d at 377-78.
45. 15 U.S.C. § 78l(g)(2)(C) (1964).
46. 15 U.S.C. 77c(a)(3) (1964); 15 U.S.C. 78c(a)(10) (1964).

ing evidence of indebtedness and excluding short term commercial paper the acts were contradictory and inconsistent. To remedy this, evidence of indebtedness was deleted.[47]

IV. THE CATCHALLS—THE INVESTMENT CONTRACT AND CERTIFICATE OF INTEREST OR PARTICIPATION IN ANY PROFIT SHARING AGREEMENT

The breadth of the definition of a "security" in the 1933 and 1934 Acts is amply demonstrated by Professor Loss' illustrations of coverage in schemes, "many of them of the Alice in Wonderland variety" involving animals, fishing boats automobile trailers, vending machines, parking meters, tung trees, and coin collections.[48] Professor Loss further points out that the various categories within the definition of the term security are not mutually exclusive and are meant to be catchalls.[49] The majority in *Tcherepnin*, after setting out the definition of a security as contained in the 1934 Act, concluded without comment that "[t]he type of interest now before us, if it is covered by this definition, must be an instrument commonly known as a security."[50] By establishing this premise the court apparently ignored the fact that this category was not intended to be a limitation upon the preceding categories,[51] and it avoided the two most litigious categories of the security definition, the "investment contract" and a "certificate of interest or participation in any profit sharing agreement."[52]

A. *The Howey & Joiner Decisions*

Probably the two most celebrated cases in the field of securities regulation are the decisions of *SEC v. C.M. Joiner Leasing Corp.*[53] and *SEC v. W.J. Howey Co.*[54] Both cases dealt with the definition of a security, and both dealt with novel and uncommon devices. Taken together the *Joiner* and *Howey* decisions establish a workable definition which has served as a polestar for the lower courts. The test "embodies a flexible rather than a static principle" in order to cope with the "variable schemes devised by those who seek the use of the money of others on the promise of profits."[55]

In the *Joiner* case the defendants engaged in a campaign to sell assignments of oil leases. The contract included, however, more than

47. 371 F.2d at 380, n.3.
48. 1 L. Loss, *supra* note 38, at 490-91.
49. *Id.* at 488-89.
50. 371 F.2d at 376.
51. Llanos v. United States, 206 F.2d 852 (9th Cir. 1953) *cert. denied*, 346 U.S. 923 (1954).
52. For an excellent discussion of various devices treated as securities within these categories see, H. SOWARDS, THE FEDERAL SECURITIES ACT 2-17 & 2-35 (1965).
53. 320 U.S. 344 (1943).
54. 328 U.S. 293 (1946).
55. *Id.* at 299.

naked leasehold rights, it also represented to the buyer that the Joiner Company was engaged in and would complete the drilling of a test well so located as to test the oil producing possibilities of the offered leaseholds.[56] The advertising literature emphasized the character of the interest as an investment and as a "participation in an enterprise."[57]

In categorizing this scheme as an investment contract and a "security" within the definition of the Securities Act of 1933, the court rejected a strict construction of the Act[58] and stated:

> [t]he reach of the Act does not stop with the obvious and commonplace. Novel, uncommon or irregular devices, whatever they appear to be, are also reached if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts" . . .
> In applying acts of this general purpose, the courts have not been guided by the nature of the assets lack of a particular document or offering. The test rather is the character the instrument is given in commerce by the terms of the offer, the plan or distribution, and the economic inducements held out to the prospect. . . .[59]

In the *Joiner* decision the Supreme Court set down certain rules of construction to be applied to the securities acts and established a method of analyzing devices to determine whether they are included within the purview of the acts. A strict or technical construction was rejected in favor of a liberal view in conformity with the acts' general remedial purpose.[60] As for the definition of a "security," "form was disregarded for substance and emphasis was placed upon economic reality."[61]

Some three years after the *Joiner* decision, the Supreme Court elaborated on the concept of the investment contract in the landmark case of *SEC v. W.J. Howey Co.*[62]

In *Howey*, the defendants offered for sale acreage planted in citrus.

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56. The simple genius of Joiner's scheme, although not pertinent to the inquiry herein, is nonetheless worthy of note. The original consideration for leases on 4,700 acres was the agreement to drill. Joiner assumed this agreement and received leases on 3,002 acres. By using his agreement to drill as an incentive, he was able to sell leases on between 1,000 and 2,000 acres at from $.00 to $15.00 per acre. Had the scheme not been thwarted, Joiner could have fulfilled his obligation to drill the well, recouped his expenses, and would still have had over one thousand acres left for the gamble, with no investment of his own.

57. The exploration enterprise was woven into these leaseholds in both an economic and legal sense; the undertaking to drill a well runs through the whole transaction as the thread on which everybody's beads were strung.
SEC v. C. M. Joiner Leasing Corp., 320 U.S. 344, 348 (1943).

58. *Id.* at 350.

59. *Id.* at 351-53

60. *Id.* at 350.

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

62. *Id.*

The land was conveyed by warranty deed. At the time of the purchase the investor was informed that the purchase of the land was not feasible unless he also made service arrangements. Service arrangements were made in eighty-five percent of the purchases with Howey in the Hills Service, Inc. Both W. J. Howey Co. and Howey in the Hills Service, Inc., were Florida corporations under direct common control and management.

The service contracts were for ten-year periods without option of cancellation, and granted to the service corporation a leasehold interest in the land with "full and complete possession." For a specified fee the service corporation was given complete authority and discretion over the cultivating, harvest, and marketing of the crops. The investor had no right of entry to market the crops without the consent of the company and there was no right to specific fruit. The company was accountable only for an allocation of the net profits.

In holding that the land sales contract, the warranty deed, and the service contract taken together constituted a sales contract, the court stated:

> [A]n investment contract for the purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party....
> ....
> If that test be satisfied, it is immaterial whether the enterprise is speculative or non-speculative or whether there is a sale of property with or without intrinsic value.[63]

The economic realities of a share account in a savings and loan association dictate that such an interest falls within the definition of an investment contract under the *Howey-Joiner* test. The investors or shareholders provide the capital for a "common enterprise" (the association) and are "led to expect profits solely from the efforts of the promoter or a third party" (the management). So closely analogous are the two situations that the following quotation from Justice Murphy's majority opinion in *Howey* could have been made in reference to the relationship between a share account holder and the savings and loan association:

> Thus all the elements of a profit seeking venture are present here. The investors provide the capital and share in the earnings and profits; the promoters manage, control and operate the enterprise. It follows that the arrangements whereby the investors interests are made manifest involve investment contracts regardless of the legal terminology in which such contracts are clothed.[64]

63. *Id.* at 298-99, 301.
64. *Id.* at 300.

The *Howey-Joiner* test has been applied by the courts to a variety of interests,[65] the majority of these decisions, however, offer very little in the way of analysis which would be of assistance in the instant case.

B. *Sale of Mortgages and Deeds of Trust*

One area of application of the *Howey-Joiner* test worthy of note involves offerings of whole or fractional interests in mortgages or deeds of trust under arrangements which provide for a variety of services to the investor. In response to an increased number of offerings of such devices the Securities and Exchange Commission issued a release in 1958 with particular reference to the status of such interests as securities.[66] In this release the Commission indicated the more common services or attributes offered in connection with these interests which in the words of the Commission "may give rise to the creation of 'investment contracts' within the meaning of the securities laws."[67] The services indicated by the commission are as follows:

(a) Complete investigation and placing service.
(b) Servicing collection, payments, foreclosures, etc.
(c) Implied or express guarantee against loss at time or providing a market for the underlying security.
(d) Making advances of funds to protect the security of the investment
(e) Acceptance of small uniform or continuous investments
(f) Implied or actual guarantee of specified yield or return.
(g) Continual reinvestment of funds.
(h) Payment of interest prior to actual purchase of the mortgage or trust note.
(i) Providing for fractional interests in mortgages or deeds of trust.
(j) Circumstances which necessitate complete reliance upon the seller, e.g., great distance between mortgaged property and investor.
(k) Seller's selection of the mortgage or deed of trust for the investor.[68]

Some two years after the Commission's release, the question of whether these devices were securities was litigated in the case of *Los Angeles Trust Deed & Mortgage Exch. v. SEC.*[69] The defendants in that case were selling through their "secured 10% earnings program," second trust deeds or mortgages. Included with these interests defendants also provided an extensive program of services. The majority of the purchasers never saw the deed of trust they purchased, no physical delivery

65. H. SOWARDS, *supra* note 52.
66. SEC SECURITIES ACT RELEASE No. 3892 (1958).
67. *Id.*
68. *Id.*
69. 285 F.2d 162 (9th Cir. 1960) *cert. denied*, 366 U.S. 919 (1960)

was made, and title was recorded in the name of the defendant.[70] Purchasers were encouraged to rely on the skill and knowledge of defendant's officers who allegedly checked the worth of the trust deeds. Defendants also serviced and made collections on the notes purchased and handled foreclosure when necessary.[71] Customers paid into "accounts" and accounts opened and additions received by the 20th of the month earned from the 1st. In addition, defendant maintained a type of account insurance in the form of a bond and reserve to prevent the purchaser from suffering a loss in the event of a default of particular trust deed. Noting that *Howey* added the test of common enterprise to the *Joiner* test of results dependant on the efforts of one other than the purchaser, the court stated:

> The terms of the offer, the peon of distribution, the economic inducements held out to the prospects, the results dependent on one other than the purchaser, the common enterprise, all combine herein to make the second trust deed notes "securities" as that term has been defined by the Supreme Court.[72]

Although varying somewhat in form, the interests offered in the *Los Angeles Trust Deed* case are strikingly similar to a share account. Funds from investors supplied the capital which was invested in secured loans on real property, while the promoter or management serviced the accounts by selection of investments, collection, allocation of earnings and foreclosure. Investors were provided with insurance to protect their investment, and funds in by the 20th of the month earn from the 1st.[73] In addition, the common services associated with the offering of whole or fractional interests in mortgages and trust deeds, indicated by the Commission's release as indicia of an investment contract, are basically those services provided to the holder of a share account by the management of a savings and loan association.

Admittedly, the two interests or devices differ structurally in that the trust deed and mortgage schemes involve the purchase of a particular

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70. *Id.* at 168.

71. *Id.*

72. *Id.* at 172. The advertising brochure of defendants had the following provisions concerning foreclosure:

> . . . .
>
> (k) [Foreclosure] is a simple procedure, and of course, we would handle the details without additional cost.
>
> . . . .
>
> (l) We notify you of such default and *give you an opportunity to foreclose the property yourself and make the extra profit* if you so desire . . . .

Id. at 168, n.3.

By allowing the purchaser to participate in this manner it would seem that his profits would be less dependent on the efforts of others. Of course, share account holders in savings and loan associations do not have a right to perform these management functions. As a result, it would seem that the Howey-Joiner element of profits dependent upon others would be even more applicable to share accounts.

73. *Id.* at 174.

deed, where savings and loan associations make their loans from commingled savings. However, this practice would seem to even better satisfy the "common enterprise" factor in the *Howey* test.

V. Method of Sale—Herein the "Doorstep" Rule

The majority opinion in *Tcherepnin* placed emphasis on the preamble of the Securities Exchange Act,[74] which in providing a brief explanation of the "necessity for regulation" refers to the sale of securities as conducted upon securities exchanges and over-the-counter markets.[75] Reasoning that the Act was passed in the aftermath of the economic disaster of 1929, the court apparently considered its scope to extend only to securities traded over exchanges or upon organized over-the-counter markets. Since a share account is, of course, not traded or sold in this manner the court reasoned that it did not come within the scope of section 10b of the Act.

Upon reading the preamble to the 1934 Act, the court's argument appears at first blush to be plausible. However, closer scrutiny of section 10b[76] under which plaintiffs sought relief, and of rule 10b-5[77] promulgated by the S.E.C. in response to the congressional authorization contained in section 10b, indicates that the scope of these provisions may not be so limited.

Section 10b provides that it shall be unlawful to use any manipulative or deceptive device or contrivance by use of means of interstate commerce, or of the mails, *or* of any facility of any national securities exchange, "in connection with the purchase or sale of any security registered on a national securities exchange *or any security not so registered.*"[78] Rule 10b-5 is not limited to exchange or organized over-the-counter trading but is applicable to the *"purchase or sale of any security."*[79] Thus, although the general statements contained in the act's preamble allude to problems existing in exchange and organized over-the-counter markets, the specific provisions of the act clearly manifest a congressional intent to regulate, with specific exclusions, all trading in securities no matter how the transaction may be conducted.

The legislative history of the Securities Exchange Act clearly indicates that Congress, by enunciating certain policy considerations involving securities exchanges and over-the-counter markets as a basis for the remedial legislation, did not intend thereby to limit the scope of the act's application to exchange and organized over-the-counter market

74. 371 F.2d at 376-77 (9th Cir. 1967).
75. 15 U.S.C. § 78b (1964).
76. 15 U.S.C. § 78j(b) (1964).
77. 17 C.F.R. § 240.10b-5 (1949).
78. 15 U.S.C. § 78j(b) (1964) (emphasis added).
79. 17 C.F.R. § 240.10b-5 (1949) (emphasis added).

transactions. This is most succinctly evidenced by the following definition of the term over-the-counter market contained in the hearings on 1938 amendments to the Securities and Exchange Act:

> Under the Securities Exchange Act of 1934, the over-the-counter markets are deemed to be all transactions in securities which take place otherwise than upon a national securities exchange.[80]

In addition to the provisions of the act, there is a substantial body of case law that has consistently refused to limit the scope of section 10b and rule 10b-5 in the manner suggested by the majority in *Tcherepnin*.[81]

In *Speed v. Transamerica Corp.*[82] the issue was squarely presented by the defendants who argued that the preamble to the act limited the scope of its provisions to "public" sales. In rejecting this contention, the court defined "over-the-counter" in a manner consistent with recovery:

> An over-the-counter transaction is simply one which does not utilize the facilities of a securities exchange, but under the unambiguous provisions of the Act it covers the sale or purchase of a security on a doorstep as well as the trading of a professional securities broker.[83]

Other courts have consistently recognized this broad interpretation of the term over-the-counter, either expressly[84] or impliedly by permitting an action to be maintained when the transaction was face to face.[85]

Utilizing these criteria set down both by Congress and by judicial decisions, the relevant inquiry is not how or where the sale of the particular item was consummated, but rather whether or not the item was a security. If the item is held to be a security then the provisions of the act are applicable whether the transaction takes place through the facilities of a securities exchange or is sold in any other manner.

VI. POLICY CONSIDERATIONS

Savings and loan associations have experienced a phenomenal rate of growth. Beginning in the war and post war period and continuing to the present the percentage of total savings invested by consumers

80. S. REP. No. 1455, 75th Cong., 3d Sess. 2 (1938); H.R. REP. No. 2307, 75th Cong., 3d Sess., 2 (1938). *See also* 3 L. LOSS, SECURITIES REGULATION 1277-78 (2d ed. 1961).

81. For a complete discussion of these decisions see: Klein, *The Extension of a Private Remedy to Defrauded Securities Investors Under SEC Rule 10B-5*, 20 U. MIAMI L. REV. 81 (1965).

82. 99 F. Supp. 808 (D. Del. 1951).

83. *Id.* at 830.

84. Matheson v. Armbrust, 284 F.2d 670 (9th Cir. 1960); Hooper v. Mountain States Sec. Corp., 282 F.2d 195 (5th Cir. 1960); Fratt v. Robinson, 203 F.2d 627 (9th Cir. 1953); Northern Trust Co. v. Essaness Theatres Corp., 103 F. Supp. 954 (N.D. Ill. 1952).

85. Errion v. Connell, 236 F.2d 447 (9th Cir. 1953); Kardon v. National Gypsum Co., 69 F. Supp. 512 (E.D. Pa. 1946).

and non-profit organizations in savings and loan associations has risen from 7.5% in 1945 to 28.6% in 1960.[86] Competition for the individual's investment within the savings and loan industry itself, and between savings and loan associations and other forms of investment is widespread and remarkably keen.[87] The consumer is faced with a barrage of inducements varying from free gifts to interest on funds from the 1st of the month if invested by the 10th. Highest and higher interest rates are advertised in addition to the even higher "bonus account" rates.[88] Although the safety aspect of a share account continues to be emphasized it now is given only brief mention while "big yields" and "high earnings" are offered as the primary inducements for what is termed "one of the soundest and most profitable investments you can find."[89] In short, the opportunities "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances under which they were made, not misleading"[90] are great.

Typically, the savings and loan share account holder is a small investor, at least as unwary and in need of protection as the individual holder of corporate stock.[91] However, there are certain countervailing factors in the form of current stock market practices which tend to provide the holder of corporate shares with some protection, at least, in the form of information not available to a holder of a share account. In 1965, 56.7% of shareholders' initial acquisitions were made with the guidance of a broker.[92] In addition, ever increasing numbers of investors are turning to mutual funds and other investment companies, where again they are provided with expert and experienced investment guidance.[93] It can, of course, be argued that since rates of return on savings and loan share accounts vary only slightly there is no need for such guidance. But

86. P. HORVITZ, PRIVATE FINANCIAL INSTITUTIONS, 286 (1963).

87. *Id.* at 278-92.

88. Bonus accounts are usually in minimum amounts of $1,000 in $1,000 multiples. Current annual interest is paid on these accounts with an additional bonus percentage earned if held for a specified period of time.

89. The emphasized portions of this sentence have all been taken from advertisements of savings and loan associations appearing in The Wall Street Journal, Nov. 2, 1967.

90. 17 C.F.R. § 240.10b-5 (1949).

91. Very little is available in the way of data upon which a comparison can be based. However, the relative income of the two groups is of some value. INSTITUTION FOR MOTIVATIONAL RESEARCH, THE U.S. SAVINGS & LOAN LEAGUE AND SAVINGS AND LOAN FOUNDATION, REPORT ON ATTITUDES 31 (1961) indicates that in 1961, 32% of the users of savings and loan associations had incomes of $5,000 or less. 58% had incomes of between $5,001 and 7,500. NEW YORK STOCK EXCHANGE, FACT BOOK 35 (1967) indicates that shareowner median household income for the year 1962 was $8,600, and $9,500 in 1965.

92. *The Stock Ownership Outlook*, 58 BANKING 33 (Part I 1965).

93. It has been estimated that by the end of 1966, 28.1% of the listed stocks on the New York Stock Exchange were held by open and closed end investment companies. NEW YORK STOCK EXCHANGE'S FACT BOOK (1967); in addition, the exchange makes periodic detailed checks of the transactions on its floor, in an effort to identify the kinds of investors behind them. Such a check made on September 13, 1961, indicated that a bare majority of the transactions (51%) involved individuals. FORTUNE, June 1963, at 208.

this argument ignores the fact that rate of return is only one factor of many that the prudent investor should consider.

Tcherepnin illustrates the pitfalls which may face the uninformed investor. At the time the plaintiffs were induced to invest in share accounts the City Savings Association was on the brink of insolvency and on a limited withdrawal basis. The association had been unable to obtain federal insurance for its shareholders,[94] and its one year Morocca insurance had not been renewed. Despite this, City Savings for lack of full disclosure requirements, was able to advertise its financial strength and appeal to prospective investors on the basis of prospective profits and security.

VII. CONCLUSION

A share account in a savings and loan association is, in economic reality, a classical illustration of the investment contract and a security within the purview of the Securities Act of 1933[95] and the Securities Exchange Act of 1934.[96] Admittedly, such a holding imposes additional regulations on an already heavily regulated industry. However, compliance with the rules and regulations of section 10b would not involve an excessive burden in light of the investor protection afforded.

[Subsequent to the time this comment was written the Supreme Court in a unanimous decision reversed the judgment of the Court of Appeals.[97] Viewing the lower court's decision as a product of misplaced emphasis, the Court held that share accounts are securities within definition of the 1934 Securities & Exchange Act. Although the Court stated that share accounts most closely resemble investment contracts, they refused to specifically categorize share accounts within any one of the descriptive terms relating to the definition of the term security, and found that the petitioners' shares fit well within several other descriptive terms contained in the 1934 Act including "certificates of interest or participation in any profit sharing agreement," "stock" and "transferable shares."]

94. Although all federal savings and loan associations are required to insure their shareholders' accounts under Federal Savings and Loan Insurance Corporation Act, state chartered associations are under no such obligation. 12 U.S.C. § 1726 (1966).

95. 15 U.S.C. 77a (1964).

96. 15 U.S.C. 78a (1964).

97. Tcherepnin v. Knight, 36 U.S.L.W. 4088 (U.S. Dec. 18, 1967).