CURRENT DEVELOPMENTS

FOREIGN BANK TIME DEPOSIT ACCOUNTS UNDER THE SECURITIES ACT OF 1933: *WOLF v. BANCO NACIONAL DE MEXICO, S.A.*

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In *Wolf v. Banco Nacional de Mexico, S.A.*[1] ("*Wolf*"), the United States District Court for the Northern District of California held that a time deposit account in a foreign bank is a "security" within the meaning of the term under section 2(1) of the Securities Act of 1933[2] because the plaintiff, a United States citizen and resident, was subject to a risk of devaluation in opening such an account.[3] In turn, the court held that defendant, Banco Nacional de Mexico ("Banamex"), which sold securities not registered with the Securities and Exchange Commission[4] was strictly

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1. 549 F. Supp. 841 (N.D. Cal. 1982).

2. 15 U.S.C.A. § 77b(1) (West Supp. 1976), as amended by P.L. No. 97-303 (1982). The Act provides that unless the context otherwise requires—

> (a) 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, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general any interest or instrument commonly known as '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.

3. 549 F. Supp. at 852-853.

4. Section 5(a) of the Securities Act of 1933, 15 U.S.C.A. § 77e(a) (West Supp. 1976) provides that "[u]nless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly (1) to make use of any means or instruments of transportation or communication in interstate commerce or of the

liable for all damages incurred by the depositor under section 12(1) of the Act.[5]

Banamex has filed a notice of appeal with the Ninth Circuit.[6] The appeal will be heard sometime later this year.

I. PRECIPITATING EVENTS

Although world developments over the last fifteen years have shaken its preeminent position, the United States dollar remains the most widely used currency in international trade and financial transactions. As a result, private and governmental entities throughout the world have a continual need for access to dollars. Latin American private businesses and governmental entities have absorbed large sums of dollar loans from United States banks, foreign banks, and local banks in order to service existing debts and to fund national industrialization.[7]

The domestic banks of foreign nations, particularly Latin American nations faced with customer demand for dollars, have had to aggressively seek new dollar sources. One method that private foreign banks use to gain dollars is to offer high interest, time deposit accounts in home currencies to United States depositors. Generally, these accounts are similar to certificates of deposit offered by United States banks. Foreign time deposits, however, must be made in the home currency of the offering bank.[8] Banks from Hong Kong, Mexico, Panama,[9] Singapore, and Switzerland have offered this type of account in the past decade.

Mexico's private sector has been especially hard pressed to

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mails to sell such security through the use or medium of any prospectus or otherwise . . ."

5. 15 U.S.C.A. § 771(1) (West Supp. 1976), which provides that

> [a]ny person who offers or sells a security in violation of section 5 . . . shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

6. No. 83-1534 (9th Cir. Nov. 1982).

7. Kuczynski, *Latin American Debt*, FOREIGN AFF., Winter 1982, at 344.

The total public and private external debt of Latin American countries reached approximately US $290 billion in mid-1982. *Id.* at 347.

Mexico, it is estimated, will have to make annual interest payments on its total external debt of approximatey 37% of total exports of goods and services. *Id.*

8. *See, e.g.*, SEC v. Fifth Avenue Coach Lines, Inc., 289 F. Supp. 3, 31 (S.D.N.Y. 1968), *aff'd on other grounds*, 435 F.2d 510 (2d Cir. 1970) ("A certificate of deposit is merely a paper evidencing the existence of a time deposit.").

9. The Panamanian currency, the Balboa, is tied to the U.S. dollar at a 1 to 1 ratio. In fact, there are few Balboas in circulation in Panama. The dollar is used in all transactions. Therefore, Panamanian home currency deposits are equivalent to domestic certificates of deposit account with respect to the currency of the deposit.

meet its dollar debt obligations which reached $15 billion in early 1982.[10] Two factors contributed to a shortage of dollars. First, flagging world demand and falling oil prices led to a drop in the inflow of dollars. Second, the peso was overvalued by approximately thirty-five percent in late 1981 due to the continuing efforts of the central bank to prop it up. Consequently, the non-oil exporting sector found itself unable to compete in world markets and unable to attract the foreign currency necessary to meet its obligations.[11]

Several Mexican banks[12] offered peso time deposit accounts.[13] United States citizens and residents, attracted by the high interest rates,[14] converted dollars into pesos and opened accounts. Some of the depositors resided in Mexico. Others crossed the border to open accounts. At least one bank opened and maintained accounts exclusively through the mail for depositors who never set foot in Mexico.

The peso time deposits were relatively safe investments for a period after the 1976 peso devaluation.[15] The Banco de Mexico, the central bank of Mexico, theoretically had let the peso float against the dollar since the 1976 devaluation. In practice, however, the central bank entered the money market to maintain the peso at an artifically high rate of twenty-three to the dollar, thus minimizing any risk of foreign currency exchange losses.[16]

On February 18, 1982 the central bank ceased its intervention and the peso fell thirty percent in relation to the dollar.[17] United States depositors whose accounts matured after devaluation received less than the original dollar principal sum when their prin-

10. N.Y. Times, Feb. 19, 1982, at D1, col. 4, D10, col. 1.

11. *Mexico Eases Down the Peso*, BUS. WK., Aug. 31, 1981, at 79.

12. Bancomer, Banco Serfin, Multibanco Comermex, and Banamex are included.

13. *Those Super-High Interest Mexican CD's*, San Francisco Exam., Apr. 5, 1981, at D1, col. 4.

14. *Id.* Interest rates on time deposits were over 30%. *See infra* notes 30-32 and accompanying text; the plaintiff in *Wolf v. Banco Nacional de Mexico, S.A.*, 549 F. Supp. at 842, received 31.4%, 32.75%, and 33.9% respectively on his three time deposits.

15. The 1976 devaluation was not technically a "devaluation." The central bank adjusted the parity level of the peso with the dollar at which it would intervene in the market from 12.50 to 22 pesos. In effect, this was the same as a 43% devaluation. *See Mexico May be Due for a Big Devaluation*, BUS. WK., June 23, 1981, at 81. *See also* R. TORRES GAYTAN, UN SIGLO DE DEVALUACIONES DEL PESO MEXICANO 324-358 (1980), for a discussion of the causes of the 1976 devaluation (balance of payments deficit, overvalued currency, depressed non-oil export sector), which were very similar to those present before the 1982 devaluation.

16. *See supra* note 10; *see also Mexico May be Due for a Big Devaluation*, *supra* note 15, at 81. In 1981 Mexico began to gradually devalue the peso. On Feb. 17, 1982, the day before the devaluation, the peso traded at 26.66 to the dollar.

17. *See supra* note 10. The peso was devalued from 26.66 to the dollar on Feb. 17, 1982 to 37.10 to the dollar on February 18, 1982.

cipal was converted from pesos to dollars.[18]

On September 1, 1982, the Mexican government nationalized all private banks[19] and converted all dollar deposits[20] into pesos at the artifically low exchange rate of seventy pesos to the dollar.[21] Shortly thereafter, the government limited the number of pesos that could be removed from the country to 5,000 per person.[22] As a result, United States and Mexican depositors with dollar accounts were able to withdraw only pesos, which could be removed from Mexico only in limited quantities.

United States citizens have brought several suits against Mexican banks over events arising out of both the devaluation and the nationalization.[23] *Wolf v. Banco Nacional de Mexico, S.A.*[24] is the first case concerning the devaluation to reach federal district court and will certainly be one of the first cases to reach the Circuit Court of Appeals when the Ninth Circuit hears the appeal sometime in 1983.[25]

II. FACTS OF THE CASE

The time deposit accounts before the court in *Wolf* are similar in most respects to certificates of deposit which are offered by United States banking institutions: (1) the depositor must open the account with a set, minimum amount for his initial deposit; (2) the accounts have a fixed term, ranging from thirty days to two years; (3) the account pays one rate of interest for its entire term and the rate is specified at the date of the first deposit; (4) interest accrues and is paid monthly without any compounding; and (5) upon maturity, the principal is returned to the depositor.[26]

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18. *See infra* notes 37-39 and accompanying text.

19. *Decreto que establece la nacionalizacion de la banca privada*, D.O., Sept. 11, 1982. Banco Nacional de Mexico, S.A. was one of the expropriated banks. *See Decreto mediante el cual se dispone que las instituciones del credito que se enumeran operen con el caracter de Instituciones Nacionales de Credito*, D.O., Sept. 6, 1982.

20. Many United States citizens still had peso deposit accounts in Mexican banks, which have not yet matured. *See, e.g., infra* note 23. Some of the plaintiff's accounts in *Davies v. Banco Nacional de Mexico, S.A.* have not yet matured.

21. *See Americans with Dollars in Mexico Hope Suit Will Recoup Big Losses*, Wall St. J., Oct. 8, 1982, at 31, col. 3.

22. *Id.*

23. *See, e.g., Frankel v. Banco Nacional de Mexico*, No. 82 Civ. 6457 (S.D.N.Y. Oct. 14, 1982), which involved a suit brought by a New York resident and U.S. citizens to attach Banamex's assets in New York after he was told that he would have to go to Mexico to collect his interest and principal in a dollar savings account and that funds would be available only in pesos. *See also Davies v. Banco Nacional de Mexico, S.A.*, C 82-6978 WWS (N.D. Cal. 1982), a class action suit pending before the district court relating to devaluation related losses on time deposits.

24. 549 F. Supp. 841.

25. *See supra* note 6.

26. *Mexico's Other Great Investment Climate* (a brochure in plaintiff's second

The accounts differ from domestic, United States certificates of deposit in two ways. First, they are peso accounts rather than dollar accounts. Therefore, a depositor holding dollars, or another foreign currency, has to first convert his money into pesos or have the bank do the conversion before the account is opened. Similarly, accrued monthly interest and the principal, upon maturity, are remitted in pesos. Banamex will reconvert the pesos into dollars if a depositor so desires.[27] Second, unlike domestic certificates of deposit which usually allow for early withdrawal upon payment of a penalty, the principal amount deposited in the Banamex accounts cannot be withdrawn before maturity.[28]

The plaintiff in *Wolf* was a citizen of the United States and a resident of the San Francisco Bay area. He never travelled to Mexico to open an account. Instead, he wrote to the Tijuana branch of Banamex in August of 1981, requesting information on time deposit accounts. The branch office mailed him a printed brochure which described the accounts and informed potential investors how to open an account.[29]

The plaintiff opened three separate peso time deposit accounts in 1981 with the Tijuana branch of Banamex. All three accounts were opened through the mail. In September 1981, he first mailed a $20,000 check to Tijuana with instructions to open a 180 day time deposit account. The bank converted the money at the prevailing exchange rate, placed 499,600 pesos in the desired account at the interest rate of 33.9%, and mailed the plaintiff a confirmation receipt and a contract. The contract, a standard printed form agreement used by the bank in connection with this type of account, was signed by the plaintiff and returned by mail to Tijuana.[30]

In November 1981, plaintiff mailed an additional $20,000 check with instructions to open a ninety day peso time deposit account. Again, the Tijuana branch converted the money at the prevailing exchange rate, opened an account with the principal sum of 514,800 pesos at an interest rate of 31.4%, and mailed the plaintiff a confirmation receipt.[31] In December 1981, the plaintiff mailed a final $20,000 check. The money was converted into pesos and the principal amount was placed in a ninety day peso time deposit. As before, the bank mailed a confirmation receipt to the

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amended complaint, 82-1328 WWS, Docket Sheet No. 25, *Wolf v. Banco Nacional de Mexico, S.A.*, 549 F. Supp. 841 (N.D. Cal. 1982)).

27. *Id.*
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*

plaintiff in the United States.[32]

The defendant, Banamex, mailed the plaintiff in the United States accrued interest payments each month. Since the accounts were peso denomination deposits, interest payments were also in pesos. The bank would convert the accrued interest into dollars at the prevailing exchange rate and mail the plaintiff the sum in the form of a United States dollar denomination check.

Prior to 1976, the Banco de Mexico, Mexico's central bank roughly analogous in function to the Federal Reserve Bank, entered the Mexican currency market to maintain a stable peso/dollar exchange rate of approximately 12.50 pesos to the dollar. In 1976, the bank adjusted the parity level of the peso with the dollar, changing the level at which it would intervene in the market from 12.50 pesos to 22 pesos, in effect devaluing the peso by 43%.[33] After the 1976 devaluation, the central bank officially claimed that the peso was a floating currency whose value was set in the market. In practice the bank continued to intervene in the market in order to maintain the exchange rate of 23 pesos to the dollar.[34] As a result of this intervention, the peso was overvalued by approximately 35% in mid-1981. The central bank made minor currency adjustments which, in effect, were a series of mini-devaluations designed to bring the peso gradually to this proper value in relation to other currencies.[35] However, world economic events threatened to plunge Mexico into a deep economic crisis.[36] Monetary policy exchanged rapidly to ward off the impending collapse. The Banco de Mexico ceased its practice of market intervention on February 18, 1982. The peso lost 30% of its value against the dollar from 26.66 pesos to 37.10 pesos to the dollar within days.[37]

The plaintiff's deposits all matured after February 18th. Upon maturity of each account, Banamex sent the plaintiff his principal and accured, unpaid interest. The plaintiff received the dollar equivalent of his peso deposit principal at the prevailing exchange rate, but the dollar sum returned as principal on each account was less than the $20,000 originally sent to Mexico as a result of the devaluation.

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32. *Id.*

33. *See Mexico May be Due for a Big Devaluation*, *supra* note 15, at 81.

34. *See supra* note 10.

35. *See Mexico May be Due for a Big Devaluation*, *supra* note 15, at 81.

36. The worldwide recession cut the demand for Mexican oil. Lower export earnings resulted from this drop in demand and Mexico found itself unable to meet its loan payment obligations.

37. Defendant's summary judgment motion, Exhibit 1, C 82-1328 WWS, Docket Sheet No. 27, *Wolf v. Banco Nacional de Mexico, S.A.*, 549 F. Supp. 841 (N.D. Cal. 1982).

The plaintiff brought suit against Banamex, alleging that the time deposits were securities under the Securities Act of 1933 and further alleging that Banamex had defrauded him in violation of section 17(a) of the 1933 Act,[38] and section 10(b) of the Securities Exchange Act of 1934[39] ("the Acts") by omitting material information on potential devaluations in the brochure they sent him.

Banamex filed a motion for summary judgment on both the securities and the fraud issues. The plaintiff filed a cross-motion for summary judgment on both issues. The district court did not reach the fraud issue, but entered a Memorandum of Opinion granting the plaintiff's cross-motion for summary judgment on the securities issue, denying Banamex's motion for summary judgment, and granting plaintiff an award of damages.[40]

III. THE DECISION

The district court took four separate steps in reaching its conclusion that foreign time deposits are securities: (1) It distinguished *Marine Bank v. Weaver*,[41] a 1982 Supreme Court decision which held that a domestic bank certificate of deposit is not a security. (2) It concluded that the so-called "*Howey* test", articulated by the Supreme Court in *SEC v. W.J. Howey*[42] and its progeny, is useful in determining which equity instruments are securities but has no application to debt instruments. (3) It rejected as unworkable and unenlightening the various standards developed by the circuit courts for defining which promissory note transactions involve securities.[43] (4) Instead, the district court, following the lead of the Second Circuit[44], fashioned a test which presumes that any instrument is a security unless it falls within a few narrowly circumscribed exceptions.[45]

A. *Marine Bank v. Weaver*

In *Marine Bank v. Weaver* ("*Weaver*"), the Supreme Court considered whether a certificate of deposit issued by a federally regulated bank is a security under the Securities Exchange Act of 1934.[46] The Supreme Court concluded that it is not. The Court in *Weaver* reaffirmed its intention to go beyond the literal language

38. 15 U.S.C.A. § 77g(a)(2) (West Supp. 1976).
39. 15 U.S.C.A. § 78(b) (West Supp. 1976).
40. 549 F. Supp. at 853.
41. 455 U.S. 551 (1982).
42. 328 U.S. 293 (1946).
43. 549 F. Supp. at 846, 847.
44. *See infra* note 74.
45. 549 F. Supp. at 851-852.
46. The definitions of a "security" under the 1933 Act and the 1934 Act are interpreted identically. Thus cases defining a "security" under either Act can be used

of the statute and to focus on the economic realities surrounding each instrument, noting that the proper test is " 'what character the instrument is given in commerce by the terms of the offer, the plan of distribution, the economic inducements held out to the prospect.' "[47] Thus, if the context in which a deposit instrument is offered requires otherwise, an instrument which would fall within the broad scope of the statutory language is not to be considered a security.[48]

The Court based its conclusion that the context required exclusion of the deposit from the coverage of the 1934 Act on two factors. First, the character of the certificate of deposit within the context of banking falls outside the realm of the ordinary concept of a security.[49] A depositor's return is fixed independently whereas a stock investor usually has a contingent return on profits. Second, the certificate was issued by a bank subject to extensive federal regulation.[50] Both factors combined, according to the Court, virtually eliminate any risk that the depositor would not receive his principal or interest. This guarantee of payment obviates the need for securities law protection.[51]

The district court held that the rationale of *Weaver* is inapplicable to the facts before it, because the Banamex accounts were not rendered risk free through insolvency insurance or a set of governmental regulations. More specifically, although Mexican banks are subject to a comprehensive set of regulations,[52] and no Mexican bank had failed to meet deposit obligations for over 50 years[53], the Mexican regulations offer no protection aginst the risk

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interchangeably. United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 847 n.12 (1975).

47. 455 U.S. at 556 (1982), *quoting* SEC v. United Beneficial Life Ins. Co., 387 U.S. 202, 211 (1967), *quoting* SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 352-53 (1943).

48. 455 U.S. at 556.

49. *Id.* at 556-557.

50. *Id.*

51. *Id.*

52. All Mexican banks operate under the supervision of the Banco de Mexico and the National Banking Commission. Under the Leyes General de Instituciones de Credito y Organizaciones Auxilores (1982) (General Laws of Credit Institutions and Auxiliary Organizations), Mexican banks are regulated in the following manner:

(1) A company must receive a concession from the Mexican government and pay in a specified amount of capital before beginning operations (arts. 2 and 8).

(2) Reserve requirements established by the government must be met (arts. 8 and 11).

(3) Peso certificates of deposit are given preferential treatment against the assets of a Mexican bank in case of financial difficulty (art. 16).

(4) Mexican banks must publish monthly and annual financial statements, which are subjected to an audit by the National Banking Commission (art. 95).

53. The Mexican government's policy has been to take over the operation of any bank in financial difficulty. As a result, no bank has defaulted on a deposit obligation

of devaluation attendant with foreign currency denominated time deposits.

B. The *Howey* Test

The Supreme Court in *SEC v. W.J. Howey Co.*,[54] defined an "investment contract" within the meaning of the term Section 2(1) of the 1933 Act as a transaction in which a buyer makes an investment in a common enterprise and is led to expect that he will receive profits solely through the mangerial efforts of a third party.[55] In *United Housing Foundation, Inc. v. Forman*,[56] the Supreme Court indicated that this test defined not only investment contracts but all securities.[57]

The district court in *Wolf* declined to apply *Howey*. The court reasoned that because the return on a debt instrument is fixed and independent of profits from an enterprise, an application of *Howey* would result in the exclusion of all debt instruments from the 1933 Act, a result which, in the view of the district court, Congress did not intend.[58]

The district court, in giving *Howey* broad application, overstated the dimensions of the problems engendered. First, many debt instruments fall within the express language of the Act, including bonds and debentures. Second, the Supreme Court has made clear in *Howey* and *Forman* that the label placed on a particular instrument does not control its treatment under the Acts. The economic realities underlying an instrument, rather than the label given by the parties, control.[59]

Several lower courts, relying on *Howey*, have held that foreign bank certificates of deposit are not securities.[60] The district court in *Wolf*, however, reasoning that their reliance on *Howey*

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in over 50 years. *See Those Super-High Interest Mexican CD's*, San Francisco Exam., Apr. 5, 1981, at D1.

54. 328 U.S. 293 (1946).

55. *Id.* at 299-301.

56. 421 U.S. 837 (1975).

57. *Id.* at 852.

58. 549 F. Supp. at 846-847.

59. 421 U.S. at 856-858. In *Forman*, although the parties in a co-op termed their purchased interest in the co-op to be shares of stock, the Court held that the shares were not securities because the economic benefit of reduced rental payments was not an expectation of profit under *Howey*.

60. *See, e.g.*, Canadian Imperial Bank of Commerce Trust Co. v. Fingland, 615 F.2d 465 (7th Cir. 1980) (complaint insufficient to establish that certificates of deposit of foreign bank are securities); and Hendrickson v. Buchbinder, 465 F. Supp. 1250 (S.D. Fla. 1979) (Bahamian bank certificates of deposit are not securities because depositor is entitled to a fixed interest return rather than dividends contingent on profits). *See also*, Brief for the United States as Amicus Curiae, Marine Bank v. Weaver, 455 U.S. 551 (1982). The United States referred with approval to *Fingland* as one of the better reasoned decisions because it did not "view the question of whether a certif-

was misplaced because of their failure to understand the debt/equity distinction, did not find these decisions persuasive.[61]

C. The Circuit Court Tests

Several circuit courts have proffered standards for determining when a note is a security. The court in *Wolf*, seizing on the fact that notes can be characterized as debt instruments, examined but rejected the various standards created by the circuit courts of appeal.

1. *The Fifth and Seventh Circuits: Investment/Commercial Dichotomy*

The Fifth and Seventh Circuits adhered to the so-called "investment/commercial dichotomy" test for determining which notes are securities.[62] The thrust of the test is that notes which are investment notes fall within the definition of a security, but notes which are commercial in nature are not securities.[63] The analysis under this test is taken on a case-by-case basis to determine if a particular note exhibits investment characteristics. In general, a note is a security under this approach if it is offered to a group of investors, is acquired for speculation or investment, or is given in exchange for an investment asset.[64] Noting that this approach is unsystematic and *ad hoc*, the district court declined to use the test in *Wolf*.[65]

2. *The Ninth Circuit: The Risk Capital Test*

The Ninth Circuit's approach for determining whether a note is a security is the "risk-capital" test. The test shares two common elements with the investment/commercial dichotomy test: it places a presumption against securities coverage unless the party asserting the claim shows that the instrument exhibits risk capital characteristics[66] and it examines the economic realities surround-

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icate of deposit is a security in the abstract, or in light of labels attached to a given instrument, but instead turned to a careful consideration of the context." *Id.* at 21.

61. 549 F. Supp. at 847.

62. For a discussion of this version of an economic realities test *see* Note, *The Economic Realities of Defining Notes as Securities under the Securities Act of 1933 and the Securities Exchange Act of 1934*, 34 U. FLA. L. REV. 400, 412 (1982).

63. *See* Williamson v. Turner, 645 F.2d 404 (5th Cir. 1981) (Since real estate purchase notes are obviously commercial in nature and not securities, there was no need in the case to develop a firm conceptual notion of an investment).

64. *See* McClure v. First National Bank of Lubbock, 497 F.2d 490, 493 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975) (Involved a note issued to secure a loan from defendant bank to a corporation in which plaintiff held stock. Held not a security.)

65. 549 F. Supp. at 847.

66. *See* Note, 34 U. FLA. L. REV. 400 *supra* note 62, for a thorough discussion of the risk-capital test; and *see* United California Bank v. THC Financial Corp., 557

ing an instrument in order to distinguish between commercial transactions, which do not involve securities, and investment transactions, which fall within the federal securities laws.

The test is derived from the Supreme Court's *Howey* test; it requires that an investor seek a return on "risk-capital" through the managerial efforts of another individual before that instrument can be classified as a security.[67] The Ninth Circuit has used a six factor analysis to determine when "risk-capital" is present.[68] The elements considered by the Ninth Circuit are: time, the existence of collateral, the form of the obligation, the number of investors, the relationship of the amount borrowed to the size of the borrower's business, and the contemplated use of the proceeds.[69] The district court in *Wolf* eschewed the risk-capital test finding it analytically suspect.[70] All of the factors are open-ended, leaving courts to speculate on the weight to give each factor. In the view of the district court, the test provides no guidance in identifying other possibly relevant factors.[71]

On appeal, the Ninth Circuit will decide whether to reaffirm the viability of the risk-capital test. If the circuit decides to use the risk-capital approach, it is not clear whether the six factor analysis will weigh in favor or against the existence of a security. The *Wolf* court came to the conclusion that the six factors did not tip the balance in either direction, but its consideration of the factors appears to mischaracterize the Ninth Circuit's original discussion of the facotrs in *Great Western Bank & Trust v. Kotz.*[72] Upon a closer reading of *Kotz*, it appears that the six factor approach would result in finding against securities coverage. The deposits were of short duration. Though not collaterized, the deposits were secured by the substantial assets of Banamex. The accounts were offered to many people. Deposits were miniscule in comparison to Banamex's total business. The funds were used for general

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F.2d 1351, 1359 (9th Cir. 1977) (placing burden on party asserting federal securities law coverage). *See also* Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1260 (9th Cir. 1976) (must show a substantial dependant relationship between risk capital and entrepreneurial efforts of third party).

67. *Id.* at 1257.

68. *Id.* at 1258-1259. *See also* United California Bank v. THC Financial Corp., 557 F.2d 1351, 1358 (9th Cir. 1977) and Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426, 432 (9th Cir. 1976) where the court also used the six factor analysis.

69. 532 F.2d at 1258. According to the court, this factor is important because proceeds used to capitalize the formation of an enterprise are generally securities, while funds spent on current operations are not.

70. 549 F. Supp. at 848-849.

71. *Id.*

72. *See Kotz*, 532 F.2d 1252, *supra* note 66. *Kotz* held that a $1.5 million unsecured 10 months promissory note a corporation gave to a bank for a line of credit was not a security because it was an ordinary commercial loan transaction.

business operations other than to capitalize a particular enterprise and the transaction took the form of a bank deposit. The *Kotz* decision strongly suggests that all the factors, except the factor that the accounts were offered to many people, weigh in favor of a finding of no "risk-capital", hence no federal securities law coverage. It is unclear whether the Ninth Circuit will introduce other factors, such as the risk of devaluation and the historical record of depositor protection in Mexican banks and how the Ninth Circuit will weigh such factors.[73]

3. *The* Wolf *Test*

Although voicing adherence to the Supreme Court's economic realities approach, the *Wolf* court adopted what is, in effect, the modified literal approach espoused by the Second Circuit. The modified literal approach evoking the broad remedial purposes of the Acts, presumes that a note is a security and places the burden of showing that the context requires noncoverage on the party seeking to avoid the application of the Acts.[74] This presumption is in direct contrast to the presumption against coverage in both the risk-capital and the investment/commercial dichotomy tests.[75]

The *Wolf* test presumes that all instruments are securities in any transaction in which someone "provides funds to another with the expectation of a financial or economic benefit . . . ."[76] Nonetheless, if the instrument falls within one of the following five categories, it is not a security: (1) benefit is derived from the managerial efforts of the investor; (2) the investor receives something of value which he intends to use or consume; (3) the provider of funds is in the business of loaning money; (4) the person

73. *Id.* at 1258. The court stated that they did not intend to "intimate that in a different case there would not be other factors to consider." *Id.* at 1255.

74. *See, e.g.*, Exchange National Bank v. Touche Ross & Co., 544 F.2d 1126, 1136 (2d Cir. 1976). This case involved 3 unsecured, subordinated notes for a total of $1.0 million which a bank bought from a brokerage house. The notes were found to be securities. The court's approach differed significantly from that of the 9th, 5th and 7th circuits. The court held that a note is presumptively a security unless the party claiming noncoverage can show that the context otherwise requires. The context exception according to the court, is limited to some defined situations, such as home mortgages, secured loans, and other commercial type loans which "bear a strong family resemblance to these examples . . ." *Id.* at 1138.

75. *See* Sanders v. John Nuveen & Co., 463 F.2d 1075 (7th Cir. 1972), *C.N.S. Enterprises, Inc. v. G&G Enterprises, Inc.*, 508 F.2d 1354 (7th Cir. 1975), and *McClure v. First National Bank*, 492 F.2d 490, *supra* at note 64, in which the court places the burden of showing the existence of a security on the party asserting federal securities law coverage.

Similarly, the Ninth Circuit places the burden on the party asserting the claim. *See supra* note 66 and United California Bank v. THC Financial Corp., 557 F.2d 1351, 1359 (9th Cir. 1977).

76. 549 F. Supp. at 851.

receiving the funds is the agent of the investor; or (5) the transaction is risk free by reason of governmental regulation.[77] After determining that only the last exception might apply, the district court concluded that the governmental regulation protecting the plaintiff in *Wolf* does not guard against the real risk to which the account was subject—the risk of devaluation.[78] Therefore, the court concluded that the deposits were securities.

IV. ANALYSIS OF THE COURT'S APPROACH

On appeal, the Ninth Circuit must first decide whether to countenance the district court's use of the modified literal approach or to follow the Ninth Circuit's risk-capital test. Given the broad definitional language of Section 2(1), adherence to the district court's modified literal approach would result in giving expansive coverage to the 1933 Act.[79]

Every person who has lost money on a transaction and who sues under the federal securities laws is benefited by a presumption that the transaction involved a "security."[80] As a result, even a disgruntled investor who is harmed by his own bad judgment enjoys a presumption of securities law coverage without the court initially analyzing the underlying economic nature of the transaction itself. Such an expansion risks transforming federal securities laws into a source of general federal jurisdiction.[81] Expansion of coverage runs counter to the thrust of recent Supreme Court decisions narrowing the coverage of the 1933 and 1934 Acts. Generally, faced with a burdensome influx of securities litigation over the past 15 years, the Court has engaged in narrower interpretation of the Acts in various nondefinitional contexts.[82] In addition,

77. *Id.* at 852.

78. *Id.*

79. *See supra* note 2 for text of definition. *See also supra* notes 45, 59 and accompanying text.

80. 549 F. Supp. at 851-852.

81. *See* Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426, 428 (9th Cir. 1978), and United California Bank v. THC Financial Corp., 559 F.2d 1351, 1359 (9th Cir. 1977), which make a distinction between risk capital and bad business judgment and state that those investors who simply make bad decisions and then attempt to get securities coverage for instruments which do not fall within the acts, should not be allowed to turn the acts into a source of general federal jurisdiction. *See also* Note, 34 U. FLA. L. REV. at 414 n. 87: "Risk capital signals a transaction in which an investor risks funds at the hands of another in anticipation of a return. In contrast, a risky loan is a commercial transaction in which a bank loans funds under circumstances where repayment is questionable . . . [this distinction prevents] a nonsecurity transaction from being converted into a security transaction by the mere fact that the investor made an unwise loan."

82. *See, e.g.*, Chiarella v. United States, 445 U.S. 222 (1980) (imposing no duty of disclosure on purchaser, absent fiduciary duty to seller); Piper v. Chris-Craft Indus., Inc. 430 U.S. 1, 45-46 (1977) (limiting relief under Exchange Act for defeated tender offerors); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 479-80 (1977) (narrowing ap-

the Court in *Weaver* used the economic realities test to give a narrow interpretation of the definition of a "security." The Court, declining to broaden the definition of a "security" to include certificates of deposit issued by domestic banks, stated that "we are satisfied that Congress in enacting the securities laws, did not intend to provide a broad remedy for all fraud."[83]

The district court's decision raises other important issues involving the Securities Act of 1933. The particulars of its expansive definitional test aside, the district court's decision turns entirely on distinguishing *Marine Bank v. Weaver*[84] on the basis of risk of devaluation.[85] According to the court, though the transactional terms of the time deposits did not differ in any material respect from those in *Marine Bank v. Weaver*, Banamex's accounts were securities because, unlike the plaintiff in *Weaver*, the plaintiff in *Wolf* was subject to a risk of foreign currency exchange loss. Thus, a customary term bank certificate of deposit, which would not be a security under the *Weaver* rationale, is transformed into a security when it is denominated in a foreign currency.

This transformation raises the issue of whether the risks associated with devaluation should be relevant in determining whether an instrument is a security under the Securities Act. Several reasons explain why the risk are irrelevant. The first reason involves the underlying purpose in enacting the Securities Act of 1933. Although the Act in part prohibits fraudulent misrepresentations in registration statements and prospectuses,[86] it is essentially a registration statute. The Act is neutral with respect to the positive or negative investment attributes of any particular security. The provisions of the statute are designed to provide meaningful disclosure thereby enabling potential investors to make informed investment decisions.[87]

The district court held Banamex strictly liable for selling unregistered securities, not for engaging in fraudulent practices. The net result of the court's decision is that foreign currency denomi-

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plication of rule 10b-5 to corporate controllers who breach fiduciary duty); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) (imposing scienter requirement for rule 10b-5 recovery); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 754-55 (1975) (limiting standing to sue under rule 10b-5 to actual purchasers of securities).

83. 455 U.S. at 556.

84. *See supra* note 41.

85. 549 F. Supp. at 853. The district court's conclusion did not turn on the fact that Banamex's time deposits were not protected by a system of depositor insurance equivalent to that provided by the FDIC (Federal Deposit Insurance Corporation). The court accepted Banamex's contention that depositors were fully protected against the insolvency risks, which FDIC insurance addresses, through the Mexican government's extensive regulatory scheme.

86. *See* 15 U.S.C. §§ 77h(d), 77j(b) (1976).

87. *See* H.R. Rep. No. 85, 73rd Cong., 1st Sess. 1-10 (1933).

nated bank accounts must be registered. This result raises the question of whether there can be meaningful disclosure of foreign currency risks to justify registering such accounts.[88] It is difficult to imagine how disclosure of foreign currency exchange risks would further the policy goals of registration. First, the risks associated with exchanging currency are known to most people. The disclosure of such risks would become nothing more than meaningless boilerplate in the registration statements and prospectuses. Second, the SEC's focus has been to encourage disclosure of information and risks specific to the issuing company and the industry in which the company operates.[89] Devaluation is one of a host of general governmental actions[90] that has an impact on the securities of an issuer but which the issuer cannot readily disclose because they are outside of the issuer's control and, in some instances, knowledge.

The second reason that supports the notion that devaluation risk should be irrelevant to defining a security concerns the status of currency under the Act. The plaintiff in *Wolf* received the full peso value of his deposited principal and interest. The plaintiff's losses resulted from a low peso to dollar exchange rate at the date of conversion from pesos to dollars. Currency is excluded from the definition of security under the Act.[91] Foreign currency is not a security.[92] Although the legislative history does not discuss why currency is excluded from the Act, one reason is readily apparent. While there might be some risks in dealings that involve United States currency (for example, inflation) or in dealings that involve

88. The *Wolf* court indicated that the risk of devaluation was specifically identified by the SEC in Regulations S-K (17 C.F.R. § 229.20, Item 11, Instruction 10), which governs registration statement requirements. Regulation S-K, however, is concerned with the disclosure of foreign government monetary policies that might affect an investor's decision on a particular security. It does not indicate that the risk of devaluation or other governmental monetary policy has an affect on whether a particular instrument is or is not a security.

89. *See e.g.*, Registration Forms S-1, S-2, and S-3 and specific items of disclosure required in these forms by Regulation S-K.

90. For example, government borrowing, the Federal Reserve Board's monetary policy, and governmental regulatory policy all have a substantial impact on the risks and return on an issuer's securities.

91. *See supra* note 2 for the definition of a security under the Act. *See also* Marine Bank v. Weaver, 455 U.S. at 557 (1982), where the Supreme Court noted that currency is not a security; and Bellah v. First National Bank of Hereford, 495 F.2d 1109 (5th Cir. 1974) in which the court noted that a certificate of deposit for currency was not a security under Section 2(1) because currency is not a security.

92. *See supra* note 2 for the definition of a security. In 1982, Congress amended the definition of a security to include an "option" on "foreign currency" in order to confirm the SEC's jurisdiction over the option market. *See* P.L. 97-303, 1996 Stat. 1409., Oct. 13, 1982 and H.R. Rep. No. 97-626, 97 Cong., 2nd Sess. 1-10 (1982). Since Congress apparently considered whether foreign currency was a security and included only options on that currency in the Act, it clearly indicated that foreign currency is not to be considered a security.

currency exchanges (for example, devaluation), it would be impracticable to require registration of currency. International banking, trade, and commercial transactions simply could not take place under a regime of registration for currency. The securities laws should not protect against risks associated solely with currency exchanges because currency is not a security.

The third reason which makes the court's attention to devaluation irrelevant involves the implication for the domestic and international banking industry. Domestic and international banks maintain foreign currency accounts and lines of credit for their customers, both commercial and non-commercial, who open such accounts for a wide range of personal and business motives. If risk of devaluation is a relevant criterion for determining which instruments are securities, the bank's actions in opening, maintaining, and closing such accounts could subject the banks to potential securities law liability. For example, if a domestic or foreign bank opens a deposit account in pounds in England for a United States resident, the mere act of using the mails to send a confirmation of such an account or account information might constitute a violation of the federal securities laws.[93]

Such a result might seem remote. Yet, one need only look to the *Wolf* case to see that courts would not be adverse to reaching the result. Banamex in the *Wolf* case communicated with the plaintiff/depositor solely through the mail. The account was opened, maintained, and closed at the bank's Tijuana branch. Although the district court in *Wolf* did not determine which acts of Banamex brought Banamex within the scope of the Securities Act, apparently the mere act of mailing the plaintiff deposit confirmations and interest payments was sufficient.

Finally, the risk of devaluation distinction between *Wolf* and *Weaver* drawn by the court does not survive close analysis. The risks of foreign currency exchange existed in both *Weaver* and *Wolf*. Devaluation risks have nothing to do with the nature of the accounts themselves. Rather devaluation risks concern the actions of the depositor. For example, any depositor in a certificate of deposit offered by the bank in *Weaver* who exchanged foreign currency for dollars would be subject to exactly the same sort of devaluation risk as that present in *Wolf* and those losses would not be protected by FDIC[94] insurance or any other federal scheme of governmental regulation.

93. 15 U.S.C. § 77e (1976) makes it unlawful to offer for sale or to sell an unregistered security through the mail.

94. Federal Deposit Insurance Corporation.

CONCLUSION

The district court's reliance on the risk of devaluation criterion is problematical in light of the potential impact of its conclusion on the domestic and international banking industry and in light of the fact that disclosure of devaluation risks will not advance the policy goals behind registration under the Act. Consequently, one would anticipate and hope that the Ninth Circuit will, at least, not affirm the reasoning of the district court.

Risk of devaluation does not distinguish *Wolf* from *Marine Bank v. Weaver*. Depositors in Banamex are thoroughly protected against insolvency losses through governmental regulation just as the depositors were in *Weaver*. Moreover, Banamex is a legitimate, reputable international bank.[95] On appeal the Ninth Circuit will have to rethink the relationship between *Weaver* and *Wolf* in order to reach a decision on whether foreign bank certificates of deposit are securities under the standards announced by the Supreme Court in *Marine Bank v. Weaver* or under some other standard, such as the Ninth Circuit's risk capital test.

95. As of Dec. 31, 1981, Banamex was the 106th largest bank in the world and had assets over $13 billion. *500 largest banks in the world*, INT'L BANKER, July 28, 1982. In addition, Banamex maintains agencies in both New York and California. Under the banking laws of the respective states, the regulatory authorities have to examine the financial condition of Banamex and the competency of its management in order to approve its banking presence within the respective states. *See* N.Y. BANKING LAW §§ 26, 40, 201, 204, and 606 (Consol. 1982); and CAL. FIN. CODE §§ 1700, 1753, and 1781 (West 1983).