To Be or Note to Be a Security: Reves v. Ernst & Young

Scott D. Museles

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TO BE OR NOTE TO BE A SECURITY:

REVES v. ERNST & YOUNG

In response to the lack of investor confidence after the stock market crash of 1929, Congress enacted the Securities Act of 1933 (1933 Act) and Securities Exchange Act of 1934 (1934 Act or collectively, Securities Acts). Through this legislation, Congress sought to "eliminate serious abuses in a largely unregulated securities market." To achieve its goal, Congress cre-

1. See FitzGibbon, What Is a Security?—A Redefinition Based on Eligibility to Participate in the Financial Markets, 64 MINN. L. REV. 893, 915 (1980) ("the following causal chain existed: (i) fraud and similar misconduct led to speculation, which, aggravated by market manipulation, resulted in (ii) the Crash, which in turn caused (iii) loss of confidence in the financial markets .... The securities laws intended to prevent the recurrence of this process."); see also 2 J. ELLENBERGER & E. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT 1934 (1973); R. POSNER, ECONOMIC ANALYSIS OF LAW 331 (2d ed. 1977).


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

   The aim is to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities ....

S. REP. No. 47, 73d Cong., 1st Sess. 1 (1933), reprinted in 2 ELLENBERGER & MAHAR, supra note 1, at item 17.


4. United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975). The preamble to the 1934 Act sets forth its objectives:

   [T]ransactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets ....

ated a complete disclosure system which included registration\(^5\) and reporting requirements\(^6\) for issuers of securities, as well as antifraud provisions.\(^7\)

By requiring disclosure of material information\(^8\) to investors, Congress hoped to reinstate investor confidence in the market.\(^9\)

While the scope of the Securities Acts encompasses a broad spectrum of transactions,\(^10\) parties seeking protection under the Securities Acts must first assert federal subject matter jurisdiction.\(^11\) For a federal court to have jurisdiction over a transaction under the Securities Acts, a party must establish that the instrument involved in the transaction is a security.\(^12\) In section 2(1)

\(^5\) Id. at §§ 77e-h. Registration is intended to provide the investor with sufficient and accurate disclosure of material facts concerning the company and the securities it proposes to sell. R. Jennings & H. Marsh, Securities Regulation—Cases and Materials 38 (6th ed. 1987). Registration requires filing a form with the Securities and Exchange Commission (SEC) that discloses, among other things, a description of the registrant's business, information about the registrant's management, certified financial statements, and a description of the security to be offered and its relationship to other capital securities of the registrant. Id. at 39. Once the registration becomes effective, the securities may be sold. 15 U.S.C. §§ 77e-h.

\(^6\) 15 U.S.C. § 78m. The reporting requirements require companies to file annual and other periodic reports with the SEC in order to update the information contained in the original registration form. In addition, annual reports must be sent to the shareholders. Extensive rules govern the disclosure of information. See, e.g., 17 C.F.R. § 240.14a-11 (1941) (regulation of disclosure in connection with shareholder elections of directors); 17 C.F.R. § 240.14d-10 (1991) (regulation of disclosure in connection with tender offers).

\(^7\) 15 U.S.C. §§ 77l, 77q (1933 Act); id. § 78j (1934 Act). Section 12 of the 1933 Act imposes civil liability on any person who violates the registration provisions and on any person who makes untrue statements or omissions in the offer or sale of a security. Id. § 77l. Section 17 of the 1933 Act provides for criminal sanctions for fraud or misrepresentation in connection with the sale of securities. Id. § 77q, x. Section 10b of the 1934 Act is a broad antifraud provision covering transactions involving the purchase and sale of securities. Id. § 78j.

\(^8\) A fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

\(^9\) See S. REP. No. 47, supra note 2.

\(^10\) In addition to conventional stocks and bonds, courts have applied the Securities Acts to an array of instruments. See, e.g., International Brotherhood of Teamsters v. Daniel, 439 U.S. 551 (1979) (noncontributory pension plans); Smith v. Gross, 604 F.2d 639 (9th Cir. 1979) (earthworm enterprise); SEC v. Koscot Interplanetary, Inc., 497 F.2d 473 (5th Cir. 1974) (franchise agreements); Glen-Arden Commodities, Inc. v. Costantino, 493 F.2d 1027 (2d Cir. 1974) (whiskey warehouse receipts).

\(^11\) Section 22(a) of the 1933 Act provides for federal jurisdiction for suits brought under that Act. 15 U.S.C. § 77v(a). Jurisdiction for suits brought under the 1934 Act is provided by section 27 of that Act. Id. § 78aa.

\(^12\) The registration, reporting, and antifraud provisions each refer to a security and therefore only apply if a security is involved in the transaction. For example, it is unlawful to sell a security "[u]nless a registration statement is in effect as to a security." 15 U.S.C. § 77e. Further, the antifraud provision in section 10b only applies to fraudulent acts "in connection with the purchase or sale of any security." Id. § 78j. The Supreme Court has recognized that the definitions of a security in both the 1933 Act and the 1934 Act are "virtually identical." United Housing Found., Inc. v. Forman, 421 U.S. 837, 847 n.12 (1975). Thus, the judicial
of the 1933 Act and in section 3(a)(10) of the 1934 Act, Congress defined "security" as broadly as possible in an attempt to ensure coverage of "the many types of instruments that in our commercial world fall within the ordinary concept of a security." The evolution of the securities markets has seen the arrival of innovative instruments that do not neatly fit the Securities Acts' definitions of a security. Consequently, the United States Supreme Court has attempted to establish universal tests or guidelines for determining whether non-traditional instruments fall within the security definition. In SEC v. W. J. Howey Co., the Supreme Court originated the underlying principle to determine the interpretation of "security" and the scope of coverage under the 1933 Act and the 1934 Act is the same. See Jacobs, The Meaning of "Security" Under Rule 10b-5, 29 N.Y.L. Sch. L. Rev. 211, 224-33 (1984). The 1934 Act defines a security as follows:

When used in this chapter, unless the context otherwise requires . . .

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, 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 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 instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

13. Id. § 77a.
14. Id. § 78c(a)(10).
15. SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946) (quoting H.R. REP. No. 85, 73d Cong., 1st Sess. 11 (1933), reprinted in 2 ELLENBERGER & MAHER, supra note 1, item 10 (1973)). Congress intended to ensure complete coverage of investments; however, most courts and commentators agree that the Securities Acts were designed to protect solely "investments" and not the everyday commercial instrument such as the private loan transaction. See, e.g., Comment, Commercial Notes And Definition of "Security" Under Securities Exchange Act of 1934: A Note Is A Note Is A Note?., 52 Neb. L. Rev. 478, 485-88 (1973) (where the author reveals Congress' preoccupation with "investments" throughout the legislative history).
16. See supra note 10. The Court in SEC v. C. M. Joiner Leasing Corp. recognized: [T]he reach of the [1933] 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 matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as "investment contracts," or as "any interest or instrument commonly known as a 'security.'"
the status of an instrument for purposes of securities regulation. In *Howey*, the Court created a test that disregards the form of the instrument and instead looks to the substance of the instrument and the economic realities of the transaction.\(^9\) Since *Howey*, the Court has modified the boundaries of the economic realities principle when attempting to determine whether a variety of unconventional instruments are covered by the Securities Acts.\(^{20}\)

Although "note" is specifically enumerated in the Securities Acts' definitions of "security,"\(^{21}\) courts do not unequivocally find notes to be securities because notes are used in a variety of contexts. A note may function as both a commercial vehicle, which is not a security,\(^{22}\) as well as an investment vehicle, which courts have deemed to be a security.\(^{23}\) Because notes may or

\(\text{\textsuperscript{19}}\). *Id.* at 298. The test is whether there is 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 [others]." *Id.* at 298-99. The Court noted that, by including "investment contract" in the definition, Congress was using a term that had been "crystallized by this prior judicial interpretation." *Id.* at 298. Therefore, the substance-over-form principle and the resulting test was based on state courts' construction of an "investment contract." See *State v. Evans*, 154 Minn. 95, 191 N.W. 425 (1922); *State v. Gopher Tire & Rubber Co.*, 146 Minn. 52, 56, 177 N.W. 937, 938 (1920); *State v. Heath*, 199 N.C. 135, 153 S.E. 855 (1930); *Klatt v. Guaranteed Bond Co.*, 213 Wis. 12, 250 N.W. 825 (1933).

\(\text{\textsuperscript{20}}\). See infra note 82.

\(\text{\textsuperscript{21}}\). 15 U.S.C. § 78c(a)(10); see supra note 12 (definition).

\(\text{\textsuperscript{22}}\). The district court in *Robertson v. White*, the lower court opinion in *Reves v. Ernst & Young*, 110 S. Ct. 945 (1990), described why commercial notes should not be securities: Because notes are included within the definition of security, the mischievous possibility exists that every time a person or a bank extends a loan to another, and receives his note in return, a federal case is made out if the obligor has failed to register his "offering" or has inflated his net worth on a financial statement. No one seriously contends that the historic 73rd Congress intended so to trivialize the regulation of securities transactions. *Robertson v. White*, 635 F. Supp. 851, 861 (W.D. Ark. 1986), rev'd sub nom. *Arthur Young & Co. v. Reves*, 856 F.2d 52 (8th Cir. 1988), rev'd sub nom. *Reves v. Ernst & Young*, 110 S. Ct. 945 (1990); see *National Bank of Commerce v. All Am. Assurance Co.*, 583 F.2d 1295, 1300-01 (5th Cir. 1978) (bank loans were devoid of investment aspects and therefore not securities); *Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc.*, 583 F.2d 426, 434 (9th Cir. 1978) (loan secured by a building was not a security because context indicated a commercial financing transaction rather than an investment of risk capital); *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1138 (2d Cir. 1976) (character loan was not a security because of commercial context); *Oliver v. Bostetter*, 426 F. Supp. 1082, 1085 (D. Md. 1977) (a note issued by individuals in connection with a consumer transaction was not a security because Congress did not intend acts to cover garden-variety notes).

\(\text{\textsuperscript{23}}\). In *Landreth Timber Co. v. Landreth*, the Court held that a note "may now be viewed as a relatively broad term that encompasses instruments with widely varying characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context." 471 U.S. 681, 694 (1985) (citing Securities Indus. Ass'n v. Board of Governors, 468 U.S. 137, 149-53 (1984)); see also *Ingenito v. Bermec Corp.*, 376 F. Supp. 1154, 1180 (S.D.N.Y. 1974) (notes given to invest in herd of cattle found to be securities based on investment character); *Hall v. Security Planning Serv., Inc.*, 371 F. Supp. 7, 14 (D. Ariz. 1974) (notes of a corporation bought by the public were investments and therefore securities).
may not be securities, the status of note instruments under the Securities Acts has perplexed federal courts. The First, Third, Fifth, Seventh, and Tenth Circuits adhered to the commercial/investment test to determine whether the Securities Acts regulate notes.24 The Sixth and Ninth Circuits employed the risk capital test.25 The Second Circuit applied the family resemblance test to determine whether a note is a security.26 Finally, the Eighth Circuit and District of Columbia Circuit applied the Howey test to note transactions to determine whether they involved regulated securities.27

24. For a discussion of the commercial/investment test, see infra text accompanying notes 114-39. Under the commercial/investment test, courts look to whether the note can be characterized as commercial or investment in nature. If the note is a commercial instrument, then it is not a security. Conversely, if a note is an investment instrument, then it is a security. See, e.g., Futura Dev. Corp. v. Centex Corp., 761 F.2d 33, 40 (1st Cir.) (promissory note issued in connection with sale of property is not a security because it was a substitute for sales price rather than an investment), cert. denied, 474 U.S. 850 (1985); Hunssinger v. Rockford Business Credits, Inc., 745 F.2d 484, 488 (7th Cir. 1984) (note issued in exchange for bank loans is commercial in nature and thus not a security); Bellah v. First Nat'l Bank, 495 F.2d 1109, 1113 (5th Cir. 1974) (renewal note from a bank loan not a security because it had no investment characteristics); Zabriskie v. Lewis, 507 F.2d 546, 551 (10th Cir. 1974) (notes given to obtain funds to promote a corporation are investments and therefore securities); Lino v. City Investing Co., 487 F.2d 689 (3d Cir. 1973) (notes used to pay for franchise center are commercial and therefore not securities). See generally FitzGibbon, supra note 1, at 937-40 (criticizing the commercial/investment test for its laundry list of factors that results in a case-by-case determination); Sonnenschein, Federal Securities Law Coverage of Note Transactions: The Antifraud Provisions, 35 Bus. Law. 1567, 1589-95 (1980) (examining the Fifth and Seventh Circuits' application of the commercial/investment test).

25. For a discussion of the risk capital test, see infra text accompanying notes 140-55. Under the risk capital test, courts determine whether risk capital was subject to the efforts of others. If the purchaser invested risk capital, then the note would be a security. See, e.g., Union Planters Nat'l Bank v. Commercial Credit Business Loans, Inc., 651 F.2d 1174, 1181-82 (6th Cir.), cert. denied, 454 U.S. 1124 (1981); Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1267 (9th Cir. 1976) (unsecured short-term note issued to secure a line of credit was not a security because issuer did not invest risk capital subject to efforts of others). See generally Sonnenschein, supra note 24, at 1595-1601 (examining the six factors of the risk capital test).

26. For a discussion of the family resemblance test, see infra text accompanying notes 156-80. Under the family resemblance test, courts presume that notes are covered by the Securities Acts unless the presumption is rebutted by showing a strong family resemblance to a judicially crafted list of non-securities. See, e.g., Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1138 (2nd Cir. 1976) (unsecured notes purchased from a brokerage house are securities because they do not resemble a listed non-security). See generally FitzGibbon, supra note 1, at 938-40 (criticizing the test for its failure to recognize which factors are relevent and how they should be weighed); Sonnenschein, supra note 24, at 1601-05 (noting that the test provides more certain and consistent decisions).

27. For a discussion of the Howey test, see infra text accompanying notes 78-92. The Howey test asks whether the instrument involves an investment of money in a common enterprise with the expectation of profits arising solely from the efforts of others. See, e.g., Arthur Young & Co. v. Reves, 856 F.2d 52 (8th Cir. 1988) (demand element of a note, though uncharacteristic of a security, may have security status under the Howey test), rev'd sub nom. Reves v. Ernst & Young, 110 S. Ct. 945 (1990); Baurer v. Planning Group, Inc., 669 F.2d 770
More than fifty years after Congress enacted the Securities Acts, the Supreme Court in Reves v. Ernst & Young finally clarified the confusion over the test courts should apply to determine whether a note is a security. By establishing a single test for notes, the Court attempted to eliminate the inconsistencies that occurred as a result of the divergent approaches of the lower courts.

In Reves, the Supreme Court rejected the Howey test for notes and adopted a modified version of the Second Circuit's family resemblance test for determining whether a note is a security. The presumption is rebutted by "showing that the note bears a strong [family resemblance] to one of the judicially enumerated categories of non-securities. Because notes are now presumed to be securities, parties issuing notes must either comply with Securities Acts' regulations or bear the burden of rebutting the presumption of coverage.

In Reves, the Farmer's Cooperative Association of Arkansas and Oklahoma, Inc. (Co-op), which had offered interest-bearing promissory (D.C. Cir. 1981) (note given in exchange for funds advanced in anticipation of securing a limited partnership interest is a security under the Howey test). See generally FitzGibbon, supra note 1, at 896-908 (examining the three prongs of the Howey test).

29. Id. 30. See infra text accompanying notes 248-94.
31. See Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976); infra text accompanying notes 156-80.
32. Reves, 110 S. Ct. at 952.
33. Id. The Court adopted the same list of non-securities that the Second Circuit drafted in Exchange Nat'l Bank:

[T]he note delivered in consumer financing, the note secured by a mortgage on a home, the short-term note secured by a lien on a small business or some of its assets, the note evidencing a "character" loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collateralized).

544 F.2d at 1138; see id. 110 S. Ct. at 952. The Court also included "notes evidencing loans by commercial banks for current operations," which the Second Circuit had previously added to its list. Id. at 951 (quoting Chemical Bank v. Arthur Anderson & Co., 726 F.2d 930, 939 (2d Cir.), cert. denied, 469 U.S. 884 (1984)). The court in Exchange Nat'l Bank devised the list relying on the "context otherwise requires" language preceding the definition of a security. 544 F.2d at 1137-38 (emphasis omitted). The court noted that the list of non-securities were "readily" thought of as cases in which the context otherwise required. Id. at 1138; see infra note 72 (discussing context clause).

34. Although the family resemblance test provides additional direction in determining whether a note will be a security, unless an issuer's note is easily characterized as one of the listed non-securities, it may be prudent for issuers of notes to comply with the federal securities laws until judicial precedent construes the Court's test. See infra text accompanying note 291-93.
notes to both members and non-members in an effort to raise capital for its general business operations, sought bankruptcy protection.\textsuperscript{35} When the Co-op went bankrupt, over 1,600 people were holding the uninsured and uncollateralized demand notes.\textsuperscript{36} A class of the holders of the notes filed suit against Arthur Young & Co.,\textsuperscript{37} the firm that audited the Co-op’s financial statements, alleging violations of the antifraud provisions of the 1934 Act and provisions of Arkansas’ securities laws.\textsuperscript{38}

The United States District Court for the Western District of Arkansas concluded that the demand notes were securities under both state and federal law\textsuperscript{39} because the Co-op offered the notes as an investment to a broad segment of the public.\textsuperscript{40} On appeal, the Eighth Circuit reversed the lower court’s holding and ruled that the notes were not securities.\textsuperscript{41} To reach its conclusion, the appellate court applied two tests previously enunciated by the United States Supreme Court.\textsuperscript{42} First, the court ruled that the demand nature of the notes disqualified them as stock according to the test articulated in \textit{Landreth Timber Co. v. Landreth}\textsuperscript{43} because the demand feature of the notes was inconsistent with traditional characteristics of a security.\textsuperscript{44} Next, the court ruled that the notes failed the \textit{Howey} test for investment contracts. Because the notes did not have the requisite profit under the \textit{Howey} test, they were deemed short-term commercial loans rather than investments.\textsuperscript{45} The United States Supreme Court granted certiorari to address whether the notes were properly excluded from the 1934 Act’s definition of a security.\textsuperscript{46}
Justice Marshall's majority opinion in Reves reversed the Eighth Circuit and ruled that the demand notes were securities within the meaning of section 3(a)(10) of the 1934 Act.\textsuperscript{47} The Court rejected the application of the Howey and Landreth Timber tests to note transactions.\textsuperscript{48} The Court explained that the tests the Eighth Circuit used are applicable to instruments other than notes and, therefore, are of little use to determine whether a note is a security.\textsuperscript{49} Then, recognizing that they had not previously analyzed what test applies to note transactions, the Court examined the various tests that the lower courts created.\textsuperscript{50} Although the Court acknowledged that the commercial/investment test is similar to the family resemblance test, the Court concluded that the Second Circuit's family resemblance test provided a better framework for analysis.\textsuperscript{51} The Court then applied the family resemblance test to the notes in Reves and concluded that the notes were securities.\textsuperscript{52}

Although the entire Court concurred with the adoption of the family resemblance test, four Justices dissented on a separate issue.\textsuperscript{53} Chief Justice Rehnquist, writing for the dissenters, criticized the majority's application of the exclusion provided in section 3(a)(10) of the 1934 Act for notes with a maturity of less than nine months.\textsuperscript{54} The majority reasoned that because the maturity of a demand note is indeterminate under federal law, the exclusion must be interpreted in conjunction with the purpose of the Securities Acts.\textsuperscript{55}

\textsuperscript{47} Reves v. Ernst & Young, 110 S. Ct. at 948; \textit{see supra} note 12 (discussing identical scope of definition under the Securities Acts).

\textsuperscript{48} \textit{Id.} at 949-51.

\textsuperscript{49} \textit{Id.}

\textsuperscript{50} \textit{Id.} at 951-52.


\textsuperscript{52} Reves, at 952.

\textsuperscript{53} \textit{Id.} at 957-60 (Rehnquist, C.J., concurring in part and dissenting in part); \textit{see infra} text accompanying notes 221-47.

\textsuperscript{54} Reves, at 957. The 1934 Act excludes short-term notes from the definition by providing:

The term “security” means any note . . . but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10). The 1933 Act contains a similar exemption. The 1933 Act exempts short-term notes from the registration provisions (or filing requirements) of the Act, but short-term notes are still subject to the antifraud provisions of the 1933 Act. \textit{Id.} § 77c(a)(3). Consequently, a note with a maturity of nine months or less is not subject to the registration provisions of either act and is covered by the anti-fraud provisions of the 1933 Act only. \textit{Id.} For a discussion of the short-term note exclusion, \textit{see infra} text accompanying notes 276-90.

\textsuperscript{55} Reves, 110 S. Ct. at 955 (majority).
Because the purpose of the Securities Acts is to prevent fraud and abuse with respect to all investments, the majority interpreted the exclusion not to cover the demand notes in Reves. The dissent, on the other hand, found the exclusion covered demand notes because courts have interpreted these notes as having an immediate maturity.

While the majority and dissent differed with respect to the meaning of the term "maturity," Justice Stevens, in a concurring opinion, rejected a literal reading of the section 3(a)(10) exclusion. Justice Stevens reasoned that the courts of appeals have unanimously construed that section to exclude only commercial paper from the definition of a security, and only Congress should alter such a settled construction.

This Note first outlines the statutory scheme of the Securities Acts. Next, this Note examines the development of the definition of a security by tracking the various Supreme Court interpretations of the term. Then, this Note reviews the federal circuit courts' applications of Supreme Court principles to notes and the various tests the circuit courts designed to determine whether a note is a security. Next, this Note analyzes Reves v. Ernst & Young, its impact on previous tests and on the corporate planner, and the effect on the applicability of the 3(a)(10) exclusion on notes. Finally, the Note concludes that Reves provides more predictability in identifying which notes are covered under the Securities Acts, but still leaves the status of short term notes in question.

I. THE STATUTORY SCHEME OF THE SECURITIES ACTS

After the Crash of 1929, Congress decided to regulate the securities markets and passed the Securities Acts to achieve its goal. The 1933 Act

56. See supra text accompanying notes 1-7; see also United Housing Found., Inc. v. Forman, 421 U.S. 837, 849 (1975) (primary purpose of the Securities Acts was "to eliminate serious abuses in a largely unregulated securities market"); cf. Marine Bank v. Weaver, 455 U.S. 551, 556 (1982) (in enacting the securities laws, Congress "did not intend to provide a broad federal remedy for all fraud").

57. Reves, 110 S. Ct. at 955.

58. Reves, 110 S. Ct. at 958 (Rehnquist, C.J., concurring in part and dissenting in part); see infra text accompanying notes 239-47.

59. See American Wholesale Corp. v. Bryant, 2 F.2d 31, 32 (5th Cir. 1924); In re Las Colinas, Inc., 294 F. Supp. 582, 595 (D.P.R. 1968); Peterson v. Valley Nat'l Bank, 102 Ariz. 434, 432 P.2d 446 (1967); Hotel Lanier Co. v. Johnson, 103 Ga. 604, 30 S.E. 558 (1898); Northcutt v. Massie, 201 Tenn. 638, 301 S.W.2d 355 (1957).

60. Reves, 110 S. Ct. at 955-56 (Stevens, J., concurring).

61. Id.

62. See note 1 and accompanying text. Section 2 of the 1934 Act provides that the securities markets are "affected with a national public interest" which necessitates efficient regulation "in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and
regulates the initial distribution of securities to the public, while the 1934 Act regulates the post-issuance trading of securities. The Securities Acts generally require parties issuing securities to file a disclosure statement with the Securities and Exchange Commission. The statement is required to disclose material information regarding the security and the issuer of the security so that potential purchasers are able to make informed investment decisions. The provisions of the Securities Acts, however, apply only when the transaction involves a security.

The definition of a security in both the 1933 Act and the 1934 Act includes specific terms such as stocks, bonds, and notes. In addition, to cast a broad net over various transactions, the definition contains catchall phrases, such as an "investment contract" and "instrument commonly known as a 'security.' " While the Securities Acts' coverage is broad, a limit placed on the scope of the Securities Acts is that the definition of a security applies "unless the context otherwise requires." An instrument may seemingly fall within one of the specific or more general terms of the definition, but a court may find that the instrument is not within the definition of security after it considers the context of the transaction. Because

64. 15 U.S.C. §§ 77a-77aa. Such markets are known as the "primary markets."
65. Id. §§ 78a-78ll. Such markets are known as the "secondary markets."
66. Section 5 of the 1933 Act prohibits the sale of securities without an effective registration statement. Id. § 78k-l(b). However, the 1933 Act provides numerous exemptions which permit the trading of securities without a registration statement or with a short-form registration statement. See, e.g., id. §§ 77c-d; 1 T. HAZEN, THE LAW OF SECURITIES REGULATION §§ 4.1-4.29 (2d ed. 1990).
67. See supra note 5 (discussing registration).
68. See supra note 12.
70. 15 U.S.C. § 78c(a)(10) (1934 Act); id. § 77b (1933 Act).
71. 15 U.S.C. § 78c(a); id. § 77b.
72. See 15 U.S.C. § 78(c)(a); id. § 77(b). There is disagreement concerning the meaning of the "context" clause. Some courts have interpreted the provision as referring to the context of the transaction being considered. See, e.g., Marine Bank v. Weaver, 455 U.S. 551, 558-59 (1982) (court held that the existence of the federal banking laws that protect purchasers of bank certificates of deposit was a context that required not finding a security); SEC v. C. M. Joiner Leasing, 320 U.S. 344, 350-51 (1943) ("courts will construe the details of an act in conformity with its dominating general purpose, [and] will read text in the light of context . . . ."); Exchange Nat'l Bank v. Touche Ross & Co., 544 F.2d 1126, 1137-38 (2d Cir. 1976) (presumption of family resemblance test may be rebutted if context otherwise requires). Other courts and commentators suggest that the prefatory language means unless the "text" otherwise requires. See SEC v. National Sec., Inc., 393 U.S. 453, 466 (1969) (in reference to the
the legislative history of the definition of a security provides little guidance, the Supreme Court has attempted to outline the scope of the Securities Acts.\textsuperscript{73}

II. THE DEFINITION OF SECURITY: A TRACE OF SUPREME COURT AUTHORITY

In \textit{SEC v. C. M. Joiner Leasing Corp.},\textsuperscript{74} the first case interpreting the definition of a security, the Supreme Court adopted a broad construction of the Securities Acts.\textsuperscript{75} In \textit{Joiner}, the Court recognized that, although an instrument may be deemed a security if it is specifically provided for in the definition, "the reach of the Act does not stop with the obvious and commonplace."\textsuperscript{76} The Court determined that "[n]ovel, uncommon, or irregular devices" may fall within the definition of a "security" if such devices can be established as "investment contracts."\textsuperscript{77}

Two years after \textit{Joiner}, the Court in \textit{SEC v. W. J. Howey Co.}\textsuperscript{78} created the economic realities test to determine whether an instrument was an invest-
ment contract and therefore a security. Instead of analyzing the form of the instrument, the Court looked to the economic reality of the transaction. Consistent with Joiner's expansive reading, the Court emphasized that an economic realities test "embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes." Under the economic realities test, an instrument is an investment contract if it is 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 [others]."  

The Howey Court created the economic realities test to determine whether instruments that were not specifically enumerated in the definition of a security were regulated securities. In United Housing Foundation v. Forman, on the other hand, the Court addressed whether an instrument that is labeled "stock" is automatically regulated under the Securities Acts because it is specifically listed. In Forman, the Supreme Court explicitly rejected a literal reading of the Securities Acts and applied a two step analysis to hold ordinary real estate transaction that was accompanied by a separate service agreement. Id. at 297-98.

79. Id. at 298.
80. Id.
81. Id. at 299.
82. Id. at 298-99. Although the economic realities and the substance-over-form principles of Howey have rarely been challenged, the individual elements in the Howey test have undergone considerable scrutiny and refinement. For example, the circuit courts disagree over the scope of "common enterprise." The Third, Sixth, and Seventh Circuits look for horizontal commonality that generally requires that the investors' funds be pooled and that the return of each investor must depend on the success of the entire venture. The Fifth, Ninth, Tenth, and Eleventh Circuits use a vertical commonality test which defines common enterprise as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or third parties." Sec v. Koscot Interplanetary, Inc., 497 F.2d 473, 478 (5th Cir. 1975) (citing SEC v. Glen W. Turner Enters., 474 F.2d 476, 482 n.7 (9th Cir.), cert. denied, 414 U.S. 821 (1973); see also Gordon, supra note 51, at 387 (proper test for determining whether a common enterprise is present is a multiplicity test which defines the term as a profit-seeking venture with multiple parallel investors). The "profits" element has also undergone some refinement. International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 561-62 (1979) (the "expectation of profits" element requires that the profits be derived from the efforts of others and cannot be insubstantial or too speculative); United Housing Found., Inc. v. Forman, 421 U.S. 837, 852-53 (1974) (defining profits as capital appreciation resulting from development of the initial investment or a participation in earnings resulting from the use of investors' funds); SEC v. Glenn W. Turner Enters., Inc., 474 F.2d 476, 482 (9th Cir.) (requirement that profits come "'solely' from the efforts of others" permits insignificant efforts by the investor), cert. denied, 414 U.S. 821 (1973).
84. Id.
85. Id. at 848. The Court relied on the principle set forth in Howey that form should be disregarded for substance when searching for the meaning and scope of "security." Id. The Court stated: "We reject at the outset any suggestion that the present transaction, evidenced by
that a stock which entitles a purchaser to lease a state subsidized apartment is not a security. 86

First, the Court examined the instrument to determine whether it possessed characteristics “traditionally associated with stock.” 87 If so, it would fall within the “ordinary concept of a security” and be a regulated instrument. 88 The instrument in *Forman* failed the traditional security test because the stock granted no right to dividends, was not negotiable, could not be pledged, conferred no voting rights in proportion to the number of shares owned, and could not appreciate in value. 89 Therefore, although the instrument in *Forman* was labeled “stock,” the Court held that it was not a security for purposes of the Securities Acts. 90 Even though the stock did not satisfy the traditional security test, the Court also analyzed whether the instrument was an investment contract under the *Howey* test. 91 The Court held that the stock was not a security under the *Howey* test because the payments of interest and the resulting tax deduction could not satisfy the profit element of the *Howey* test. 92

86. *Id.* at 837. The case centered around the massive cooperative housing project in New York City called “Co-op City.” *Id.* at 840. The project housed approximately 50,000 people and was designed to provide low-income urban housing. *Id.* The United Housing Foundation (UHF), a nonprofit corporation, was responsible for initiating and sponsoring the development of the cooperative. *Id.* UHF organized the Riverbay Corporation, which issued the stock to operate the land and buildings of Co-op City. *Id.* at 841. To acquire an apartment, the prospective purchasers were required to buy 18 shares of stock for $25 each for each room desired. *Id.* at 842. The shares were not transferable and had no voting rights. *Id.* If a tenant wished to move out, he was required to offer the stock back to Riverbay at the original price. *Id.* In its information bulletin for prospective purchasers, there was also estimated a monthly rental charge of $23.02 per room to finance a portion of the project. *Id.* at 843. Subsequently, the costs of the project increased, as did the monthly rental charge (to $39.68). *Id.* at 843-44. The increase precipitated the suit alleging violations of the antifraud provisions of the 1933 Act for failure to disclose several critical facts. *Id.* at 844.

87. *Id.* at 851; see infra text accompanying note 89 (listing the characteristics of traditional stock).


89. *Id.*

90. *Id.*

91. *Id.* at 851-52. Applying *Howey*, the Court clarified the profits element of the *Howey* test by defining profit as capital appreciation resulting from development of the initial investment or a participation in earnings resulting from the use of investors’ funds. *Id.* at 852.

92. *Id.* at 855. The Court also rejected the idea that the substantially lower cost of renting an apartment through the Co-op constituted profits. *Id.* The Court reasoned that such a benefit cannot be converted into cash and does not result from the efforts of others. *Id.* After *Forman*, the Supreme Court addressed whether a certificate of deposit (CD) and a separate business agreement were securities under the 1934 Act. *Marine Bank v. Weaver*, 455 U.S. 551 (1982). In *Marine Bank*, the Supreme Court relied on the “context otherwise requires” language preceding the definition of a security in section 3(a)(10) to determine that the CD and
Prior to *Forman*, the Court had emphasized the need to examine the economic realities of a transaction. Indeed, the Court in *Forman* recognized that "[b]ecause securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction."\(^9\)

The traditional security test in *Forman*'s analysis, however, signaled a retreat from the economic realities principle by examining the character of the instrument rather than the economic realities of the transaction. In *Forman*, the Court examined the economic realities of the transaction only after the instrument failed the traditional securities test. After *Forman*, it was unclear whether or not an examination of the economic realities under *Howey* was required when the status of an instrument as a security was in question.\(^9\)

In *Landreth Timber Co. v. Landreth*,\(^9\) the Court, recognizing that its previous tests had not been clear, attempted to clarify the test which should be applied in determining whether an instrument was a security.\(^9\) The instrument in *Landreth* was also labeled "stock."\(^9\) The Supreme Court held that "[i]nstruments that bear both the name and all of the usual characteristics of stock seem to us to be the clearest case for coverage by the plain language of the definition,"\(^9\) making it unnecessary to examine the economic reality of the agreement were not securities. *Id.* at 558-59. The Court held that because the federal banking laws and federal insurance plans eliminated investor risk, the context of the transaction in *Marine Bank* required that the instrument not fall within the scope of the Securities Acts. *Id.* The elimination of risk proved dispositive because if the transaction was sufficiently protected under the federal banking laws, then the transaction was outside the protective scope of the securities laws. *Id.* The Court cited to its decision in *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 (1979), where the Court held that a noncontributory, noncompulsory pension plan was not a security partially because the instrument was already regulated by Employee Retirement Income Security Act (ERISA). *Marine Bank*, 455 U.S. at 558-59. The *Marine Bank* Court also found that the agreement was not a security. *Id.* at 560. In *Marine Bank*, the Weavers pledged the CD to secure a loan for a company and the company agreed to pay the Weavers a share of the profits in return. *Id.* at 553. The Court ruled that, because the agreement was a private transaction and not publicly traded, it was not a security. *Id.* at 560.


94. One commentator noted that after the *Forman* decision, "*[t]he difficulty in determining whether a note is security is no longer fairly great. It is immense. . . . [W]e now know that no 'note, stock, etc.' is a security unless it is also an investment contract. Defining 'security' is now as easy as defining pornography." Hammett, *supra* note 72, at 25-26.


96. *Id.* at 688.

97. *Id.* The parties entered into a stock purchase agreement for all of the stock of Landreth Timber. *Id.* at 683. The lumber business did not live up to the purchaser's expectations and the purchaser sold the company at a loss. *Id.* at 684. The purchaser then filed suit against Landreth, the seller, alleging that he violated the registration and antifraud provisions of the 1933 Act. *Id.*

98. *Id.* at 693.
the transaction.\(^9\) Therefore, while the Court in \textit{Landreth} embraced the traditional security test of \textit{Forman},\(^{10}\) it implicitly limited its holding to instruments labeled stock, noting that stock is distinguishable from all the other listed categories of instruments.\(^ {10} \) The Court reasoned that an investor justifiably assumes that a sale of stock is covered by the Securities Acts, but that the same could not be said for any other type of instrument.\(^ {10} \)

The holding in \textit{Landreth Timber} limited the scope of the \textit{Howey} test by determining that the economic realities are examined only if the instrument did not pass the traditional security test.\(^ {10} \) The Court refused to address whether the traditional security test was applicable to other listed instruments.\(^ {10} \) However, the Court acknowledged that notes are used in both commercial and investment contexts, implying the difficulty that might occur if it were to use the traditional security analysis for notes.\(^ {10} \)


\(^{10} \) \textit{Id.} at 691.

\(^{10} \) \textit{Id.} at 693-694.

\(^ {10} \) \textit{Id.} at 693. The Court noted that "traditional stock 'represents to many people, both trained and untrained in business matters, the paradigm of a security.'" \textit{Id.} (citing \textit{Daily v. Morgan}, 701 F.2d 496, 500 (5th Cir. 1983)).

\(^ {10} \) \textit{Id.} at 690; \textit{see Jones, Footnote 11 of Marine Bank v. Weaver: Will Unconventional Certificates of Deposit Be Held Securities?}, 24 Hous. L. Rev. 491, 512 (1987) (the Court's "restriction of the \textit{Howey} test curtails the scope of the securities laws").

\(^{10} \) \textit{Id.} 471 U.S. at 694.

\(^ {10} \) \textit{Id.}
The common thread among a number of the Court's post-Howey decisions was the need to examine the economic realities of the transaction rather than the form of the instrument to determine whether that instrument was a security. The Howey test was, in effect, synonymous with an economic realities approach and, therefore, was perceived as the universal test for determining whether the instrument was regulated under the Securities Acts. As the Landreth Court noted, however, all of the cases in which the Court had employed an economic realities test involved unusual instruments that were not easily characterized as securities. When the Court was confronted with traditional stock, an instrument specifically enumerated in the definition, it applied a traditional security test. When the Court applied the traditional security test, it did not examine the economic realities of the transaction but instead limited its analysis to the characteristics of the instrument. Although the Court refused to address whether the same analysis could apply to notes or one of the other listed categories, it became apparent that while the Howey test would apply to uncommon instruments, other listed categories of instruments needed separate tests.

III. ARE NOTES SECURITIES? CIRCUIT COURT METHODOLOGY

Although the Court had examined the contours of the definition of a security, it never applied the definition to notes. In the absence of Supreme Court authority on note transactions, the circuit courts established their own methodology for determining the Securities Acts' coverage for notes. The circuits have created three tests to determine the status of notes under the Securities Acts: the commercial/investment test, the risk capital test, and the family resemblance test. Although each of these tests has a different conceptual focus, their outcomes are often the same.

106. The Forman Court noted that the Howey test was the basic test for distinguishing a transaction involving a security from a commercial dealing and that it "embodie[d] the essential attributes that run through all of the Court's decisions defining a security." United Housing Found., Inc. v. Forman, 421 U.S. 837, 852 (1975).
107. Landreth, 471 U.S. at 690.
108. Id.
109. Id.
110. See infra text accompanying notes 114-39.
111. See infra text accompanying notes 140-55.
112. See infra text accompanying notes 156-80.
113. Futura Dev. Corp. v. Centex Corp., 761 F.2d 33, 40 (1st Cir.) (the conceptual basis of the three tests and the factors examined by the courts tend to be very similar although the focus is slightly different), cert. denied, 474 U.S. 850 (1985); see also American Bank & Trust Co. v. Wallace, 702 F.2d 93, 95 (6th Cir. 1983) (court suggests that although the circuits are split with respect to which analysis is appropriate, the results reached under the tests are virtually identical); Home Guar. Ins. Corp. v. Third Fin. Servs., Inc., 667 F. Supp. 577 (M.D.
A. The Commercial/Investment Test

A majority of the federal circuits have adopted the commercial/investment test for determining whether a note is a security. Under this test, courts distinguish between notes of an investment nature and notes of a commercial nature. Only notes that are investment in nature are considered securities and are subject to federal securities regulation. In making the distinction, the courts have delineated a number of factors to examine the economic context of the transaction.

In *McClure v. First National Bank of Lubbock, Texas*, the court applied the commercial/investment test to a promissory note and deed of trust given by a corporation to secure a loan from a bank. McClure, a fifty percent controlling shareholder of a corporation, consented to a loan evidenced by a note based on representations made by the bank and Hanslik, the other fifty percent shareholder, that the proceeds were necessary to pay corporate obligations. Hanslik subsequently used the proceeds from the loan to repay his personal debts. McClure brought suit against Hanslik, the bank, and the loan officer of the bank alleging violations of the 1934 Act.

The court identified three factors that, when considered together, would establish the note as a security. The court considered whether the note

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114. See supra note 24 (circuit courts using commercial/investment test).
115. See supra note 24.
116. See *Futura Dev. Corp.*, 761 F.2d at 40; *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 488 (7th Cir. 1984); *Bellah v. First Nat'l Bank*, 495 F.2d 1109, 1112-13 (5th Cir. 1974); *Zabriskie v. Lewis*, 507 F.2d 546, 551 (10th Cir. 1974); *Lino v. City Investing Co.*, 487 F.2d 689, 691 (3d Cir. 1973).
117. See infra notes 118-134.
119. *Id.* at 491.
120. *Id.* at 491-92.
121. *Id.* at 492.
122. *Id.* at 493.
was: offered to some class of investors, purchased for speculation or investment purposes, and offered in exchange for a type of investment asset. If these criteria were met, according to the court, it would indicate the note was an investment and therefore a security. In McClure, the court ruled that the note was not a security because it was not publicly offered and because the note actually operated as a loan rather than an investment asset.

In Futura Development Corp. v. Centex Corp., the First Circuit considered whether a promissory note issued as partial payment for a tract of land and secured by a mortgage on the property was a security. Futura Development Corporation sold a tract of land to a subsidiary of Centex Corporation in return for cash, a promissory note secured by a mortgage, and an assumption of a mortgage that Futura had previously taken on the land. When Centex's subsidiary defaulted on the note, Futura brought suit claiming violations of the antifraud provisions of the Securities Acts. Centex argued that the promissory note was not a security within the protection of the Securities Acts.

In applying the commercial/investment test, the court identified several factors, in addition to those listed in McClure, that it deemed relevant in distinguishing investment notes from commercial notes. Specifically, the court looked to the size of the offering, reliance by the purchaser on the efforts of the issuer, the purposes of both parties in entering the transaction, and the economic inducements held out to the purchaser. Because the note in Futura was the result of one-on-one business negotiations and was

123. Id. at 493-94. Although the court noted that the first two factors usually indicate investment overtones, the court stated that other factors may be considered. Id. at 493 n.2 (citing Comment, supra note 15, at 510-524). The factors that the author suggests are: the public's expectations, the issuer's use of the proceeds, the risk of the transaction, the number of notes issued, the dollar amount of the transaction, the maturity of the note, and the characterization of the notes on the issuer's financial statements. Comment, supra note 15, at 510-24.
124. McClure, 497 F.2d at 493.
125. Id. at 493-94.
127. Id. at 36.
128. Id.
129. Id. at 36-37. Futura alleged that Centex made fraudulent representations regarding their intentions to purchase the entire tract of land which would violate section 10b of the 1934 Act. Id. at 38.
130. Id.
131. Id. at 41.
132. Id. (citing Marine Bank v. Weaver, 455 U.S. 551, 556 (1982). The court also noted other factors that have been given consideration:

[T]he degree to which the profit on the note is in the hands of the maker rather than the payee; whether the object of the holder was to acquire an interest in the property or enterprise; whether the note was primarily commercial because it was serving as a "cash substitute" for the purchase price; and whether the return on the note was
for a definite amount with a predetermined interest rate, the court held that
the note was a substitute for the sales price of the land and not dependent on
the efforts of Centex.133 Accordingly, the court found the note to be com-
mercial in nature and not a regulated security.134

The commercial/investment test is consistent with the Supreme Court’s
rulings that the economic realities of the transaction and not the form of the
transaction should determine whether an instrument is a security.135 Some
commentators and courts, however, complain that the commercial/inves-
tment test leads to inconsistent results.136 Further, while the language of
section 3(a)(10) would cover all notes unless the context otherwise re-
quired,137 the commercial/investment test presumes that the Securities Acts
do not cover notes unless their investment nature is shown.138 Therefore,
the commercial/investment test places the burden of proof on the party as-
serting coverage under either of the Securities Acts to demonstrate the note
was for investment purposes.139
B. The Risk Capital Analysis

Although a majority of the circuits apply the commercial/investment test, the Ninth and Sixth Circuits determine whether a note is a security based on whether risk capital\(^{140}\) has been contributed subject to the entrepreneurial or managerial efforts of another.\(^{141}\) This risk capital approach is consistent with the economic realities principle announced in \textit{Howey} because it examines the context of the transaction rather than the form of the instrument.\(^{142}\) The test differs from the economic realities test, however, because it focuses on the relationship of the parties to the transaction rather than on the characterization of the instrument as an investment.\(^{143}\)

In \textit{Great Western Bank & Trust v. Kotz},\(^{144}\) an early case applying the risk capital test, a corporation issued an unsecured short-term note to Great Western Bank in exchange for a line of credit.\(^{145}\) When the corporation later defaulted on the note and declared bankruptcy, Great Western brought suit against Kotz, the president of the corporation, to recover its losses.\(^{146}\)

To determine whether the transaction involved a security, the court analyzed whether the funding party, Great Western, invested risk capital subject to the managerial efforts of the corporation.\(^{147}\) Specifically, the court determined whether the purchaser sufficiently risked his capital by considering the time of maturity of the note, collateralization of the note, form of the obligation, circumstances of its issuance, relationship between the amount borrowed and the size of the borrower's business, and the intended use of the proceeds.\(^{148}\) The court held that Great Western had not invested risk capi-

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140. The court recognized that a "risk" inquiry is difficult:
In one sense every lender of money is an investor since he places his money at risk in anticipation of a profit in the form of interest. Also in a broad sense every investor lends his money to a borrower who uses it for a price and is expected to return it one day.

Great Western Bank & Trust v. Kotz, 532 F.2d 1252, 1257 (9th Cir. 1976) (quoting C.N.S. Enters., 508 F.2d at 1359).


142. \textit{See supra} text accompanying notes 78-82.


144. 532 F.2d 1252 (9th Cir. 1976).

145. \textit{Id.} at 1254.

146. \textit{Id.} at 1253.

147. \textit{Id.} at 1256-60.

148. \textit{Id.} at 1257-58. The court also noted that no single factor is determinative and that other fact patterns may require an inquiry into other factors. \textit{Id.} at 1258.
nal dependent on the efforts of the corporation. The court emphasized the significance of the note's time of maturity and held that a demand or short-term note is almost "*ipso facto* not a security unless payment is dependent upon the success of a risky enterprise." The court reasoned that because the bank maintained significant control over the corporation, any risk beyond the risk normally associated with commercial lending had been eliminated.

Several commentators have supported the risk capital test as the method to define an instrument as a security. They argue that risk is an important factor that distinguishes securities from commercial transactions. Likewise, one commentator has criticized the test noting that risk depends on the obligor's financial standing rather than a function of the transaction. Finally, similar to the commercial/investment test, the risk capital test also presumes an instrument is not covered by the Securities Acts and places the burden of proof on the party asserting coverage under either of the Securities

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149. *Great Western*, 532 F.2d at 1260. Although the note in *Great Western* was unsecured, the accompanying loan agreement placed several limitations on Artko. Id. at 1254-55. The agreement demanded that Artko maintain a minimum balance of at least $300,000, that it maintain working capital of at least $4,000,000, that it engage in no further unsecured loans, and that Great Western could declare default or renegotiate if signs of insecurity were to arise. Id. Thus, these factors gave the bank considerable control over Artko and the bank did not contribute risk capital. Id. at 1259-60.

150. Id. at 1257.

151. *See supra* note 149.

152. *Great Western*, 532 F.2d at 1259-60.

153. *See* Coffey, *The Economic Realities of a "Security": Is There a More Meaningful Formula?*, 18 CASE W. RES. 367, 381-96 (1967); Long, *An Attempt to Return "Investment Contracts" to the Mainstream of Securities Regulation*, 24 OKLA. L. REV. 135, 167-70 (1971); Hannan & Thomas, *supra* note 72, at 241-249; Comment, *supra* note 15, at 513-14. The Supreme Court, however, refused to adopt a risk capital analysis in *United Housing Found., Inc. v. Forman*, 421 U.S. 837, 857, n.24 (1975). The Court’s refusal to adopt the test was actually circular in reasoning. Its reasoning was based on the fact that the purchasers of the apartments in the co-operative take no risk, from which it followed that the risk capital test could not be applied. Id. The risk of insolvency that the respondents in *Forman* mentioned “differs vastly from the kind of risk of 'fluctuating' value associated with securities investments.” Id. (quoting SEC v. Variable Annuity Co., 359 U.S. 65, 90-91 (1959) (Brennan, J., concurring)).

154. *See* Sonnenschein, *supra* note 24, at 1595 1601. If the lender shoulders most of the risk, the borrower's risk consequently diminishes. *See id.* Because coverage depends on the proportion of risk allocated to the parties, the status of the lender's note varies inversely with the status of the borrower's note. *See id.* This inconsistency severely undermines the value of the risk capital test in determining whether a note is a security.
Acts to show that risk capital was contributed subject to the efforts of others.\textsuperscript{155}

\textit{C. Family Resemblance Test}

In \textit{Exchange National Bank v. Touche, Ross & Co.},\textsuperscript{156} the Second Circuit created yet another test, the family resemblance test, to apply in determining whether a note is a security. Relying on a literal reading of section 2(1) of the 1933 Act,\textsuperscript{157} the court established a rebuttable presumption that all notes with a term of more than nine months are securities.\textsuperscript{158} Unlike the commercial/investment and risk capital tests, the family resemblance test presumes notes are covered and places the burden of proof on the party wishing to rebut that presumption.\textsuperscript{159} The party can rebut the presumption by showing that the instrument bears a "strong family resemblance" to an instrument that the court has deemed is clearly not a security.\textsuperscript{160}

\textit{Exchange National Bank} involved the purchase of three unsecured subordinated notes from Weiss Securities Inc., a brokerage firm and member of the New York Stock Exchange.\textsuperscript{161} The notes became worthless after Weiss went into receivership and defaulted on the notes.\textsuperscript{162} Exchange National Bank brought suit under the Securities Acts against Touche Ross, the accountant who prepared the financial statements for the transaction, alleging false and misleading entries.\textsuperscript{163} Touche Ross filed a motion to dismiss for want of subject matter jurisdiction claiming that the notes were not securities and therefore were not subject to securities regulation.\textsuperscript{164}

\begin{itemize}
\item \textsuperscript{155} See \textit{Great Western}, 532 F.2d at 1253.
\item \textsuperscript{156} 544 F.2d 1126 (2d Cir. 1976). Two cases that preceded \textit{Exchange Nat'l Bank} also adopted a literal approach to the Securities Acts. \textit{Exchange Nat'l Bank}, however, is credited for establishing the current family resemblance test. The first case was \textit{Movielab, Inc. v. Berkey Photo, Inc.}, 452 F.2d 662 (2d Cir. 1971), which involved a sale of assets by defendant corporation in exchange for two twenty-year notes by plaintiff corporation. The court read the statute literally to encompass the transaction. \textit{Id.} at 663. The second case involved a parent corporation forcing its subsidiary into a loan evidenced by a demand note which was found to be a security. \textit{Zeller v. Bogue Elec. Mfg. Corp.}, 476 F.2d 795, 799 (2d Cir.), \textit{cert. denied}. 414 U.S. 908 (1973).
\item \textsuperscript{157} See infra note 166.
\item \textsuperscript{158} \textit{Exchange Nat'l Bank}, 544 F.2d at 1137-38.
\item \textsuperscript{159} \textit{Id.}
\item \textsuperscript{160} \textit{Id.} at 1138.
\item \textsuperscript{161} \textit{Id.} at 1128.
\item \textsuperscript{162} \textit{Id.}
\item \textsuperscript{163} \textit{Id.}
\item \textsuperscript{164} \textit{Id.}
\end{itemize}
After expressing dissatisfaction with both the risk capital test and commercial/investment tests, the Second Circuit noted that the “best alternative . . . may lie in greater recourse to the statutory language.” The court examined section 2(1) and adopted the plain meaning of the statute to create a presumption of coverage of all notes with a term of more than nine months. The court made clear that the presumption may be rebutted if the party seeking to avoid coverage can prove that the “context otherwise requires” finding the note to be a security. The court illustrated six instances, or contexts, that it deemed were obvious commercial notes and thus not securities. The court concluded that, unless the note “bear[s] a strong family resemblance” to one of these six examples of non-securities provided, all notes with a maturity of more than nine months are covered under the Securities Acts.

The six illustrations created in Exchange National Bank that may rebut the presumption, however, are not exclusive. In Chemical Bank v. Arthur Andersen & Co., the Second Circuit considered whether a replacement note which evidenced loans made by a commercial bank to finance current operations could be a security. The court recognized that “this approach does not afford complete certainty but it adheres more closely to the language of the statutes and it may be somewhat easier to apply then the weighing and balancing of recent decisions of sister circuits.”

165. Id. at 1135-37. The court noted that “[d]irecting district courts to ‘weigh’ a number of such dubious factors, without any instructions as to relative weights . . . is scarcely helpful.” Id. at 1137.

166. Id. at 1137. The statutory language of section 2(1) of the 1933 Act reads: “[U]nless the context otherwise requires . . . [t]he term ‘security’ means any note, . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months.” 15 U.S.C. § 78c(a)(10) (1988).

167. Exchange Nat’l Bank, 544 F.2d at 1137. The court recognized that “this approach does not afford complete certainty but it adheres more closely to the language of the statutes and it may be somewhat easier to apply then the weighing and balancing of recent decisions of sister circuits.” Id. at 1138.

168. Id. But see supra note 72 (discussing the meaning of the context clause).

169. Exchange Nat’l Bank, 544 F.2d at 1138. The examples stated were: consumer financing notes, notes secured by home mortgages, short-term notes secured by a lien on a small business or its assets, notes evidencing a character loan to a bank customer, short-term notes secured by an assignment of accounts receivable, or notes formalizing an open-account debt incurred in the ordinary course of business. Id.; see also Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930, 939 (2d Cir.) (adding to the list “notes evidencing loans by commercial banks for current operations”), cert. denied, 469 U.S. 884 (1984).

170. Exchange Nat’l Bank, 544 F.2d at 1138. The presumption only exists if the note has a maturity of nine months or more because of the statutory exclusion in the definition. Id. at 1137-38. The family resemblance test recognizes the exemption whereas the commercial/investment test has been viewed as essentially writing the exclusion out of the law. See McClure v. First Nat’l Bank, 497 F.2d 490, 495 (5th Cir. 1974) (“the investment or commercial nature of a note entirely controls the applicability of the Act, depriving of all utility the exemption based on maturity-length”). Id.

171. Exchange Nat’l Bank, 544 F.2d at 1138. The court left “for another day” the status of a note that has a maturity of nine months or less and does not bear a strong family resemblance to a listed non-security. Id. at 1138 n.19.

operations of a borrower was a security. After acknowledging that Exchange National Bank did not list replacement notes, the court held that Exchange National Bank's enumerated list of non-securities was not "graven in stone." Accordingly, the court held that the replacement note was not a security and added it to the list of non-securities.

The presumption of coverage in the Second Circuit's family resemblance test shifts the burden of proving coverage to the party asserting that the note does not fall within the Securities Acts' protection. Further, the family resemblance test's strength lies in its textual basis and increased predictability. The concrete examples of non-securities provide a more workable framework than an analysis into the various factors that different courts have articulated for both the commercial/investment and risk capital tests. Notwithstanding the increased predictability that the examples provide, commentators have criticized the test for failing to articulate the common characteristics that distinguish the examples of non-securities from securities. Critics have also charged that it is difficult to find a strong resemblance to those enumerated non-securities without knowing the factors the court used to distinguish them from securities. The circuit courts have been unable to agree on a single test to determine when a note is a security. Accordingly, when the Court addressed the issue in Reves v. Ernst & Young, it could have chosen from a variety of tests and factors in crafting a test to determine whether a note is a security.

IV. Reves v. Ernst & Young: Settling the Disagreement Among the Circuit Courts Over When a Note Is a Security

In Reves v. Ernst & Young, the Supreme Court adopted the Second Circuit's family resemblance test and presumed that a note is a security unless it bears a strong resemblance to one of the enumerated categories of

173. Id. at 936-39.
174. Id. at 939.
175. Id.
176. See Exchange Nat'l Bank, 544 F.2d at 1137-38. Although the court did not discuss the burden of proof, a presumption of coverage implicitly places the burden on the party opposing coverage.
177. See, e.g., Note, supra note 143, at 418 (the "concrete examples ... provide the predictability that is absent in the investment/commercial and risk capital tests"); Sonnenschein, supra note 24, at 1603 ("Exchange National Bank represents a step towards greater certainty and consistency of decision than is available under the other formulations").
178. See supra notes 114-55 and accompanying text.
179. See Comment, supra note 143, at 773.
180. Id.
notes that are not securities. The Court expanded the Second Circuit’s test, however, by adding factors to help determine whether the note bears a strong resemblance to a listed non-security. If no resemblance to an enumerated non-security is found, the Court noted that the same factors may be examined to determine whether the instrument in question should be added to the list. The Court also held that the demand note in Reves did not fall within the exclusion in the statute for notes with a maturity of nine months or less. Thus, the presumption of coverage adopted by the Reves Court, as opposed to the presumption of non-coverage in the other tests, potentially broadens the scope of the Securities Acts. As judicial precedents develop and instruments are added to the list of non-securities, however, the Securities Acts’ scope will likely be narrowed.

A. The Majority’s Analysis

1. Limiting the Howey and Landreth Timber Tests

Both the majority and dissent in Reves accepted the rebuttable presumption of the family resemblance test. The majority first examined a line of prior Supreme Court opinions that interpreted the definition of a security. Justice Marshall, writing for the majority, dismissed the application of the Landreth Timber test to notes. The Court interpreted the Landreth Timber analysis as a “per se” rule limited to instruments that bear the traditional characteristics of stock. Justice Marshall reasoned that because the investing public’s perception of stock as a security is well-grounded, stock is

182. Id. at 952. The Supreme Court’s version of the test did not include the language, “with a term of more than nine months” but instead presumed “all” notes to be securities. Id. at 951 n.3 (emphasis in original). In a footnote, the Supreme Court attributed this modification to its refusal to interpret the exclusion for notes with a maturity of nine months or less. Id. Instead, the Court chose not to reach the meaning of that exclusion. See infra text accompanying notes 221-31 (discussing the exclusion).

183. Reves, 110 S. Ct. at 951-52.


185. Reves, 110 S. Ct. at 954-55.


187. Reves, 110 S. Ct. at 952.

188. Id. at 949-50.

189. Id. at 950.

190. Id.
the "quintessence" of a security and therefore a special case. Justice Marshall recognized that a note, on the other hand, can be employed in either a consumer context or an investment context and that the public does not necessarily perceive it as a security. He then held that because of the varying contexts in which notes are used, the phrase "any note" in section 3(a)(10) cannot be literally interpreted to mean any note, but instead must be analyzed against the "backdrop" of what Congress attempted to achieve in enacting the Securities Acts.

Next, Justice Marshall reviewed the various tests the circuits applied to determine whether a note is a security. He explicitly rejected the application of the Howey test to notes, asserting that the Howey test was designed solely to determine whether an instrument is an investment contract, not whether it is among any of the listed categories of securities. Turning to the other tests, Justice Marshall recognized that although the family resemblance test and the commercial/investment test are similar approaches, the family resemblance test "provides a more promising framework for analysis." Accordingly, after years of circuit disagreement over how to determine whether a note is a security, the Court in Reves cleared up the confusion by adopting the family resemblance test.

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191. Id. (citing Landreth Timber Co. v. Landreth, 471 U.S. 681, 693 (1985)). Professor Loss' discussion of whether instruments labeled stocks are securities also supports this reasoning:

It is one thing to say that the typical cooperative apartment dweller has bought a home, not a security; or that not every installment purchase "note" is a security; or that a person who charges a restaurant meal by signing his credit card slip is not selling a security even though his signature is an "evidence of indebtedness." But stock (except for the residential wrinkle) is so quintessentially a security as to foreclose further analysis.


192. Reves, 110 S. Ct. at 950.

193. Id.

194. Id. at 950-51.

195. Id. at 950. Justice Marshall reasoned that "[t]o hold that a 'note' is not a 'security' unless it meets a test designed for an entirely different variety of instrument 'would make the Acts' enumeration of many types of instruments superfluous.' " Id. at 951 (quoting Landreth Timber, 471 U.S. at 692). The Court apparently also rejected the risk capital test which it viewed as a "virtually identical" approach to that taken in the Howey test. Id. at 951 (citing Underhill v. Royal, 769 F.2d 1426, 1431 (9th Cir. 1985)). In Forman, however, the Court had rejected a risk capital analysis and adopted the Howey test as a second step of its analysis. Forman, 421 U.S. 837, 852 & 857 n.24 (1975); see supra note 153 (discussing Forman's rejection of the risk capital test).

196. Reves, 110 S. Ct. at 951.
2. Family Resemblance "Plus"

While the Court settled the disagreement among the circuit courts when it adopted the family resemblance test, the Court did not stop there. Indeed, the Supreme Court observed that the test should provide additional guidance. For example, the Court noted that under the family resemblance test, courts have difficulty resolving whether an instrument resembles one of the listed non-securities. Justice Marshall, therefore, specified four factors to determine whether an instrument strongly resembles a listed non-security or whether an instrument should be added to the list: the motivations of the buyer and seller, the plan of distribution of the instrument, the public expectation that the instrument is a security, and the existence of a risk reducing factor.

First, the Court considered the motivations of the buyer and seller to enter into the transaction. Justice Marshall reasoned that if the seller's motivation was to raise money for a business venture or finance an enterprise and the buyer's motivation was to gain a profit, then the note would likely be a security. If, however, the seller's motivation was to assist in purchasing a minor asset or consumer good or to advance some other consumer purpose, then the note would less likely be deemed a security. Applying the motivation factor to Reves, the Court noted that the Co-op used the funds to raise capital and that the investors' motivation in purchasing the notes was the profit provided by an interest rate that would be adjusted to stay above the rate paid by banks. Accordingly, the Court determined that the motivation factor indicated an investment in a business enterprise rather than a consumer transaction and therefore was indicative of a security.

197. Id.
198. The courts applying the family resemblance test never enunciated the characteristics which qualified the listed instruments as non-securities. Id. The Court in Reves noted that "[i]t is impossible to make any meaningful inquiry into whether an instrument bears a 'resemblance' to one of the instruments . . . without specifying what it is about those instruments that makes them non-'securities.'" Id. (emphasis in original).
199. Id. at 951-52.
200. Id. The motivation factor was borrowed from the Forman opinion, which refused Securities Act coverage because the buyer's motivation was to acquire affordable housing, a commercial purpose, rather than to invest for profit. Forman, 421 U.S. 837, 851, 858 (1975).
201. Reves, 110 S. Ct. at 951-52. In a footnote, the Court defined profit as "'a valuable return on an investment,' which undoubtedly includes interest." Id. at 952 n.4. The Court, however, limited this definition of profit to the family resemblance test and refused to extend the definition of profit to the Howey test. Id.
202. Id. at 952.
203. Id.
204. Id. at 952-53.
205. Id. at 953.
Next, the Court considered the "plan of distribution" of the instrument and looked to whether the instrument was commonly traded for speculation or investment purposes. If the note was commonly traded, the note would likely be found a security. Although "common trading" suggests a secondary market for the instrument, the Court instead found that the demand notes issued in Reves satisfied the common trading requirement because they were issued to a "broad segment of the public."

The Court then turned to the public expectations factor. The Court indicated that if the public reasonably believed or expected that the instrument was a security, then it may be deemed a security, even where the circumstances of the transaction suggest that the instrument was not a security. As applied to Reves, the public expectation was that the notes were securities because the advertisements characterized the notes as investments and because no countervailing factors alerted the average investor to question this characterization.

Finally, the Court held that the presence of any risk reducing feature, such as coverage under other regulations, may result in noncoverage. Justice Marshall reasoned that if there was no risk or only limited risk involved in purchasing the note, then protection under the Securities Acts would be unnecessary. Because the notes in Reves were uninsured and uncollections...
ized, and no other federal regulation covered the notes, the Court found no risk reducing factor.\footnote{214} Accordingly, after considering the motivations of the buyer and seller, the plan of distribution, the public expectations and whether there was a risk reducing factor, the Court held that the demand notes in \textit{Reves} were securities under the family resemblance “plus” test.\footnote{215}

For the demand note in \textit{Reves}, the Court’s new family resemblance test proved easily applicable.\footnote{216} All the factors were satisfied and the Court presumed coverage.\footnote{217} What remained, however, was the exclusion for notes with a maturity of nine months or less under section 3(a)(10).\footnote{218} Because the notes in \textit{Reves} were demand notes, Ernst \& Young argued that they were excluded as short-term notes under the 1934 Act.\footnote{219} Although the notes may have otherwise qualified as securities under \textit{Reves’} family resemblance test, their ultimate status under the 1934 Act hinged upon the interpretation of the exclusion.\footnote{220}

3. \textit{A Literal Application of the Short-Term Note Exclusion}

The majority and dissenting opinions differed over the application of the statutory exclusion for notes with a maturity of nine months or less.\footnote{221} Although the weight of authority limits the application of the exclusion to commercial paper,\footnote{222} Justice Marshall found it unnecessary to look beyond

\begin{itemize}
\item \footnote{214} \textit{Id.} at 953.
\item \footnote{215} \textit{Id.} The Court also dismissed the appellate court’s finding that the notes in \textit{Reves} were not covered by the Securities Acts because they were demand notes. \textit{Id.} The appellate court held that demand notes do not have the risk normally associated with a security. Arthur Young \& Co. v. Reves, 856 F.2d 52, 54 (8th Cir. 1988), \textit{rev’d sub nom.} Reves v. Ernst \& Young, 110 S. Ct. 945 (1990). In rejecting the lower court’s reasoning, Justice Marshall analogized the risk of a demand note to the instant liquidity of stock, the paradigm security. \textit{Id.} He recognized that risk is only eliminated from notes when the note is paid, whereas the risk in stock is minimized by the availability of the national exchanges. \textit{Id.} He concluded that the risk inherent in a demand note, therefore, is at least as great as the risk associated with stock. \textit{Id.}
\item \footnote{216} \textit{See supra} text accompanying notes 200-15.
\item \footnote{217} \textit{See id.}
\item \footnote{218} \textit{Reves}, 110 S. Ct. at 954.
\item \footnote{219} \textit{Id.}
\item \footnote{220} \textit{See infra} text accompanying notes 221-47.
\item \footnote{221} \textit{Reves}, 110 S. Ct. at 954. The 1934 Act excludes notes that have a maturity of nine months or less from both the reporting and antifraud provisions of that Act. 15 U.S.C. § 78c(a)(10) (1988). The 1933 Act, however, only exempts short-term notes from the registration provisions, not from the antifraud provisions. \textit{Id.} § 77b. Because this case was brought under section 10b of the 1934 Act, it was necessary for the Court to address the exclusion under the 1934 Act.
\item \footnote{222} \textit{See Securities Act Release No. 33-4412, 26 Fed. Reg. 9158 (1961)} (the Commission construed section 3(a)(3) of the 1933 Act exemption to include only prime quality commercial paper); \textit{see also} Holloway v. Peat, Marwick, Mitchell \& Co., 879 F.2d 772, 778 (10th Cir. 1989) (refusing to read exemption literally, limiting it to prime quality commercial paper), \textit{cert.
the plain meaning of the Securities Acts and therefore gave literal effect to the statute.223 The Court recognized that the Securities Acts clearly exclude from the definition of a security any note with a maturity of nine months or less.224 Whether the note in Reves fell within the exclusion depended on the Court's construction of the term maturity in the context of a demand note.

Ernst & Young argued that state statute of limitations determined the maturity of demand notes.225 Justice Marshall, however, declined to rely on state law to determine whether a demand note had matured.226 The Court recognized that relying on state law to determine whether an instrument is a security would result in inconsistent application of the Securities Acts.227 Consequently, the Court held that the maturity of notes for purposes of the Securities Acts is a matter of federal law.228 Under federal law, however, the maturity of a demand note is indeterminate.229 The Court concluded, therefore, that because the legislative intent of the Securities Acts is to ensure the protection of all investments from fraud and abuse,230 the exclusion did not apply to the demand notes in Reves.231

223. Reves, 110 S. Ct. at 954.
225. Reves, 110 S. Ct. at 954. Respondents argued, as did the dissent, that state law has interpreted that, in the context of the statute of limitations, notes payable on demand have immediate maturity. See infra text accompanying notes 239-47. Because the maturity of a demand note is immediate under state law, they argued, it is less than nine months and falls within the exclusion. Reves, 110 S. Ct at 954.
226. Reves, 110 S. Ct. at 954.
227. Id. Justice Marshall predicated that such a holding might result in an instrument being deemed a security in one state while being excluded in another state. Id.
228. Id.
229. Id. at 955. Justice Marshall asserted that "the words of the statute are far from 'plain' with regard to whether demand notes fall within the exclusion." Id. He then noted:

If it is plausible to regard a demand note as having an immediate maturity because demand could be made immediately, it is also plausible to regard the maturity of a demand note as being in excess of nine months because demand could be made many years or decades into the future.

Id. (emphasis in original).
230. See 2 ELLENBERGER & MAHAR, supra note 1; Rep. No. 47, 73d Cong., 1st Sess. 1 (1933), reprinted in supra note 2 (quoting Senate Reports discussion of the LEGISLATIVE HISTORY 1933 Act's goals.
231. Reves, 110 S. Ct. at 954.
B. The Concurrence: Construing the Nine-Month Exclusion

Justice Stevens concurred with the majority's holding that demand notes do not fall within the exclusion. Instead of relying on a literal reading of the exclusion, however, Justice Stevens deferred to the weight of authority that interprets the exclusion as limited to prime quality commercial paper. Justice Stevens argued that because the courts of appeals and the Securities and Exchange Commission have unanimously rejected a literal reading of the exemption, only Congress should disturb such a well-settled construction.

Justice Stevens also noted that the “context otherwise requires” language preceding the definition of a security supports a judicial construction that balances “the facially rigid terms of the nine-month exclusion with the evident intent of Congress.” He summarily held that the legislative history of the exclusion was intended to cover only commercial paper and therefore the demand notes in Reves did not fall within the nine-month exclusion.

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232. Id. at 955-56 (Stevens, J., concurring).
233. Id.; see infra notes 285-87. Commercial paper is used by corporations and other business entities that need to borrow substantial sums of money for short-term use. It usually is evidenced by short-term unsecured promissory notes and is generally less expensive than conventional bank loans. The SEC has defined the type of commercial paper that is excluded from the definition of a security. See infra text accompanying note 286.
236. Reves, 110 S. Ct. at 956. Justice Stevens noted: “[A]fter a statute has been construed, either by this Court or by a consistent course of decision by other federal judges and agencies, it acquires a meaning that should be as clear as if the judicial gloss had been drafted by the Congress itself.” Id. (Stevens, J., concurring in part and dissenting in part) (quoting Shearson/ American Express Inc. v. McMahon, 482 U.S. 220, 268 (1987)).
237. Id. at 957 (citing Exchange Nat'l Bank v. Touche, Ross & Co., 544 F.2d 1126, 1132-33 (2d Cir. 1976)).
238. Id. Justice Stevens failed to cite the legislative history that he relied on but instead cited Sanders, 463 F.2d at 1079, which relied on Securities Act Release No. 33-4412. See infra text accompanying note 286. An examination of the legislative history, however, does reveal Congress’ concern for exempting commercial paper. See, e.g., S. REP. No. 47, 73d Cong., 1st Sess. 4 (1933), reprinted in 2 ELLENBERGER & MAHAR, supra note 1, at item 17 (“It is not intended under the bill to require the registration of short-time [sic] commercial paper which, as is the usual practice, is made to mature within a few months and ordinarily is not advertised for sale to the general public.”); H.R. REP. No. 85, 73d Cong., 1st Sess. 15 (1933), reprinted in
C. The Dissent: Demand Notes Have Immediate Maturity

In his dissent, Chief Justice Rehnquist also followed a literal approach to the exclusion but instead relied on the common understanding of the term "maturity." The Chief Justice countered the majority's assertion that state law is not controlling by noting that, in the absence of federal law, the Court depends on the contemporaneous meaning of the words at the time the statute was enacted. The majority of state courts at the time of enactment of the Securities Acts had established that demand notes had immediate maturity, bringing the notes in Reves within the exclusion.

Chief Justice Rehnquist noted that the proposed language in the legislative history on which Justice Stevens relied to exclude commercial paper did not survive the final enactment of the Securities Acts. The broadening of the language in its final form, according to the dissent, indicated that commercial paper is only one of a potentially larger group of instruments that the exclusion is designed to cover. The dissent's interpretation, therefore, also refused to recognize the longstanding belief that the exclusion was limited solely to commercial paper.

2 Ellenberger & Mahar, supra note 1, at item 15 (section 3(a)(3) of the 1933 Act applied to "short-term paper of the type available for discount at a Federal Reserve bank and of a type which rarely is bought by private investors.").

239. Chief Justice Rehnquist was joined by Justices White, O'Connor, and Scalia. Reves, 110 S. Ct. at 957 (Rehnquist, C.J., concurring in part and dissenting in part).

240. Id.


242. See id. at 957-960.

243. 110 S. Ct. at 958.

244. Id. at 958-59; see supra notes 232-38.

245. Reves, 110 S. Ct. at 958-59. The Court quoted the original Senate report, which stated that "[n]otes, drafts, bills of exchange, and bankers' acceptances which are commercial paper and arise out of current commercial, agricultural, or industrial transactions, and which are not intended to be marketed to the public, are exempted . . . ." Id. at 959 (emphasis in original) (quoting S. REP. No. 47, 73d Cong., 1st Sess. (1933), reprinted in 2 Ellenberger & Mahar, supra note 1, Item 17)). The Chief Justice then quoted the broader enacted version: "[a]ny note, draft, bill of exchange, or banker's acceptance which arises out of a current transaction or the proceeds of which have been or are to be used for current transaction, and which has a maturity at the time of issuance of not exceeding nine months." Id. (emphasis in original) (quoting 15 U.S.C. § 77c(a)(3)).

246. Reves, 110 S. Ct. at 959-60.

247. Id.
V. THE SUPREME COURT GIVES THE BENEFIT OF THE DOUBT TO ALL NOTES

The Supreme Court in Reves both clarified and left unclear the status of notes as securities. The Reves' family resemblance test and its presumption that all notes are securities is consistent with the plain terms of the Securities Acts248 and provides lower courts with additional guidance to determine when a note is a security.249 Still, Reves has its weaknesses. Further, the majority's refusal to confront the exclusion for short-term notes leaves the status of such notes unclear.

A. The Family Resemblance Test: Giving Effect to the Plain Meaning of the Statute Provides Predictability

Reves' rebuttable presumption of coverage for any note is consistent with the plain terms and broad nature of the Securities Acts.250 The Securities Acts cast a broad net over the types of instruments covered.251 Congress sought to include as many different types of instruments as necessary to ensure maximum investor protection.252 The Reves' family resemblance test furthers the Securities Acts' goal of protecting the investor rather than simply regulating or not regulating an instrument based on its label or characterization. For example, Reves' fourth factor is whether another regulatory scheme reduces the risk of the instrument.253 The rationale of the risk-re-

248. The plain terms of the statute indicate that all notes are securities unless the context otherwise requires. See supra note 12 (quoting the definition of security).
249. See infra text accompanying notes 250-61.
250. But see Sonnenschein, supra note 24, at 1605 (arguing that the presumption of coverage may be too inclusive on policy grounds).
251. See supra note 10.
253. 110 S. Ct. 945, 950 (1990). The Court's language did not limit the risk-reducing factor to only regulatory schemes and, indeed, some post-Reves' courts have considered insurance or collateralization as sufficient risk-reducing factors in holding an instrument as a non-security. See Singer v. Livoti, 741 F. Supp. 1040, 1050 (S.D.N.Y. 1990); Diaz Vicente v. Obenauer, 736 F. Supp. 679, 692 (E.D. Va. 1990); Caucus Distrib., Inc. v. Alaska Dep't of Commerce & Economic Dev., 793 P.2d 1048, 1056 (Alaska 1990). But see Gordon, supra note 51, at 397-98 (noting that secured bonds are securities under the Securities Acts and therefore collateralization is not a sufficient risk reducing factor). It would be inconsistent with the disclosure philosophy of the Securities Acts, however, to permit issuers of investment instruments to escape coverage by privately insuring or collateralizing the instrument. The underlying philosophy of the Securities Acts is not to eliminate the risk that the investor will lose his money as a result of an unsound economic decision. Rather, the "risk" the Securities Acts seek to avoid is investor losses based on incomplete or fraudulent disclosure that induces investors into purchasing the instrument. See Long, supra note 153, at 159 ("[t]he purpose behind [a disclosure statute] is to see that the investor has the necessary information before him to make an intelligent investment decision . . . . It does not attempt to pass on the soundness of the investment or to
ducing factor is that where the risk of the instrument is reduced, the investor is sufficiently protected and does not need protection under the Securities Acts. Further, while the main goal of the Securities Acts is to protect the investors, Congress was also concerned with over-burdening the business community. Requiring issuers of notes to comply with the Securities Acts' regulations when the investor is already sufficiently protected would be unwarranted. Thus, not only is Reves' fourth factor consistent with the goal of protecting investors, but it is also consistent with Congress' concern not to interfere with "honest business."

The Supreme Court's version of the family resemblance test also provides greater predictability than other tests designed to determine whether notes are securities. The list of non-securities, in conjunction with the pre-existing four factors raised in Reves, provide additional direction as to whether...
a note is covered under the Securities Acts.\textsuperscript{258} Although Reves' flexibility may lead to vague or abstract formulations of the attributes of a security,\textsuperscript{259} the concrete examples of non-securities constrain vague formulations.\textsuperscript{260} Further, because it is flexible, the family resemblance test can be adapted to the endless number of transactions that involve notes. A \textit{per se} test would otherwise enable the shrewd investment promoter to escape Securities Act coverage by working around a more determinate test.\textsuperscript{261}

\subsection*{B. Reves' Four Factors: The Majority's Failure to Guide Their Application}

While the concrete examples of non-securities in the Reves' test has provided some additional guidance, the relative weights of the four factors used to find resemblance to the non-securities is uncertain. The Reves' Court stated that the four factors it devised are the factors that the Court has previously applied in deciding whether a transaction involves a security.\textsuperscript{262} Yet it is unclear from the Court's opinion whether all four factors must be met or

\begin{footnotesize}
\begin{itemize}
\item[258.] See Sonnenschein, supra note 24, at 1603 (Second Circuit's family resemblance test "represents a step towards greater certainty and consistency of decision than is available under the other formulations"). \textit{But see} Steinberg, supra note 186, at 684 (author argues that the test is indefinite unless the particular note falls within one of the enumerated categories).
\item[259.] See Sonnenschein, supra note 24, at 1603.
\item[260.] See id.
\item[261.] One commentator has noted that because note transactions involve infinite variations, such variation could be employed to "undermine even the most comprehensive test for the determination of antifraud coverage." Sonnenschein, supra note 24, at 1588. Further, a more determinate test could attain even greater certainty, but only at the expense of the Court's stated desire to retain a "flexible rather than a static principle" in interpreting the Securities Acts. SEC v. W. J. Howey Co., 328 U.S. 293, 299 (1946); see also SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963) (federal securities legislation "'enacted for the purpose of avoiding frauds' [is to be construed] not technically and restrictively, but flexibly to effectuate its remedial purposes") (quoting 3 SUTHERLAND, STATUTORY CONSTRUCTION 382 (3d ed. 1943)). The Reves Court also noted the advantages of a flexible approach:

An approach founded on economic reality rather than on a set of \textit{per se} rules is subject to the criticism that whether a particular note is a "security" may not be entirely clear at the time it is issued. Such an approach has the corresponding advantage, though, of permitting the SEC and the courts sufficient flexibility to ensure that those who market investments are not able to escape the coverage of the Securities Acts by creating new instruments that would not be covered by a more determinate definition. One could question whether, at the expense of the goal of clarity, Congress overvalued the goal of avoiding manipulation by the clever and dishonest. If Congress erred, however, it is for that body, and not this Court, to correct its mistake.

110 S. Ct. 945, 950 n.2 (1990).
\item[262.] 110 S. Ct. at 951-52. Indeed, the Court cites to specific Supreme Court decisions after describing each factor. See supra text accompanying notes 200-12.
\end{itemize}
\end{footnotesize}
whether a balancing approach must be applied to determine whether the instrument is a security.

With respect to the "risk reducing" factor, however, the Court stated that application of the Securities Acts was "unnecessary" if a risk-reducing factor was present.263 Thus, if Securities Act coverage is "unnecessary," an instrument will not be a security, irrespective of the other three factors.264 If another regulatory scheme is not present, however, an examination of the other three factors becomes essential.

The Court's language is far more ambiguous with respect to the application of the other three factors. If the Court intended a balancing approach with respect to these factors, the predictive capability of the test would be reduced because the Court failed to give the relative weights of each factor.265 A balancing approach, however, is consistent with the Court's desire for flexibility and its concern that sophisticated promoters could easily circumvent a more rigid test.266 Moreover, although a three factor balancing approach may suffer from the same indefiniteness as both the commercial/investment and the risk capital tests,267 the Reves' family resemblance test provides a list of specific examples to guide the courts' application of the factors to the instrument in question. Finally, because the factors are used to find "resemblance" to a listed non-security, the Reves' Court may have intended a more subjective balancing approach.

263. Reves, 110 S. Ct. at 952.

264. The Court's discussion of Marine Bank as support for the fourth factor suggests that it will be dispositive. Reves, 110 S. Ct. at 953. In Marine Bank, the Court held that the existence of the federal banking laws provided sufficient protection to the investor of a CD and therefore that the CD was not a security. Marine Bank v. Weaver, 455 U.S. 551, 559 (1982). The Court in Reves also cited to Daniel, where the Court supported its holding that a non-contributory pension plan was not a security by noting that it was sufficiently regulated by ERISA. Reves, 110 S. Ct. at 953 (citing International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 569-70 (1979)); see also Schneider and Cohen, supra note 253.

265. See Gordon, supra note 51, at 398.

266. See supra note 261. The Court noted that because the definition was framed in such broad terms and the legislative history indicates that it was intended to be interpreted flexibly, the Court believed it was bound to a flexible test and that only Congress can "correct its mistake." Reves, 110 S. Ct. at 950 n.2.

267. See supra text accompanying notes 136-38, 154-55. By naming the factors that it believes are most relevant in determining whether a note is a security, the Court eliminated the multitude of factors thought to be relevant under the commercial/investment test. Under the commercial/investment test, courts could inquire into any one of a long list of factors that judicial precedent deemed relevant to distinguish investment notes from commercial notes. By narrowing the list to four factors in Reves, the Court has essentially weighed the factors of the commercial/investment test and eliminated the uncertainty as to what factors the courts must consider. But see Schneider & Cohen, supra note 253, at 199 (predicting that courts will reach result-oriented outcomes, and then that the motivations and public expectations factors will be "recited appropriately in a manner consistent with the result reached").
Furthermore, because it is theoretically possible to find that a note is a security even if one factor is not met, a balancing approach is necessary. First, the plan of distribution factor, was satisfied in *Reves* because the notes were issued to a broad segment of the public. It is conceivable, however, that a security will be found even where the instrument is not issued to the general public. Second, the issuer's motivation and public expectations factors will often be indeterminate. Because an issuer often has multiple purposes for issuing notes, the motivations factor probably should be neutral, rather than one that weighs against finding a security. In addition, although the public expectations factor proved easily applicable in *Reves* because the instruments were advertised as investments, an investor typically would not have any expectation about the characterization of the instrument under the Securities Acts. Indeed, earlier in the opinion, the Court recognized that an investor may assume that stock is covered under the Securities Acts, but that the same could not be said of notes because of the variety of

269. This is particularly true when securities are sold to a few institutional investors. Furthermore, in *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), the Court found that stock sold to a single investor was a security. 471 U.S. at 697. Arguably, the plan of distribution factor should not be relied on in determining whether an instrument is a security. The Securities Acts provide specific exemptions from the registration and reporting requirements, but not the antifraud provisions, for issuances that do not involve public offerings. This suggests that Congress intended that instruments that are issued to a few investors must remain subject to antifraud provisions and may still be deemed securities.
270. See Schneider & Cohen, *supra* note 253, at 196 (“A typical business enterprise generates funds from multiple sources and uses them for multiple purposes more or less simultaneously.”) On the other hand, the purchaser's motivation will most likely always be clear because of his interest in the profit of the note. But see Steinberg, *supra* note 186, at 680 (unless it is clear that the seller's motivation is solely commercial and the buyer's motivation is not for profit, the notes should be securities provided the remaining three factors are met).
271. Schneider & Cohen, *supra* note 253, at 198. Arguably, the Court's language indicates that the public expectations factor may in some cases be dispositive. The Court stated that it would find a security based on the reasonable expectations of the investing public, “even where an economic analysis of the circumstances of the particular transaction might suggest that the instruments are not 'securities' as used in that transaction.” *Reves*, 110 S. Ct. at 952. This approach is similar to that used in *Landreth Timber* for stock. *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985). The *Reves* Court suggests that if the customer reasonably believed that he was investing in a security, then the Court will find a security, regardless of the economic realities of the transaction. This probably does not reveal, however, that the Court will disregard the remaining two factors. First, the public expectations factor will be guided by the investors' motivations or purposes, the first factor in the analysis. Second, the public expectations factor assumes that the instrument was distributed to the public, thereby satisfying *Reves*’ second factor, the plan of distribution. Thus, although it appears from the Court's language that the public’s reasonable expectations will be dispositive, an inquiry into public expectations inherently includes an inquiry into the motivations and plan of distribution factors.
contexts in which they are issued. Theoretically, then, if the issuer's motivations and the public expectations are unclear, and no regulatory scheme that reduces the risk exists, the Reves' family resemblance test hinges on the plan of distribution. Thus, as certain factors will undoubtedly be unclear, it is probable that courts must weigh the Reves' factors to determine whether the instrument in fact strongly resembles a listed non-security.

C. The Short-Term Note Exclusion

The majority in Reves was unwilling to settle the long-standing debate over the application of the exclusion for notes with a maturity of nine months or less, but instead offered a limited holding with respect to demand notes. Although the petitioners based their argument on the widely held view that the exclusion is limited to commercial paper, the majority indicated that it was unnecessary to look beyond the plain meaning of the Securities Acts and held that demand notes are not excluded.

The Court's decision that demand notes are not covered under the exclusion rested on its interpretation of the term "maturity." Justice Marshall determined that when a note matures is a question of federal law, not state law. The majority refused to follow state law fearing that it would result in inconsistent application of the Securities Acts. The majority's concern was misplaced. The absence of any federal interpretation of a demand note's maturity implicitly requires the Court to start with a clean federal slate and

272. Reves, 110 S. Ct. at 950. Given the difficulty that courts have had in determining when a note is covered under the Securities Acts, it is hard to imagine that the average investor, or even the institutional investor, would necessarily expect coverage under the Securities Acts. Indeed, the Reves' family resemblance test is supposed to eliminate the uncertainty in determining when a note is a security. The Court's focus on public expectations, however, is not on a reasoned determination requiring the average investor to analyze the note under the family resemblance test. The analysis is more likely focused on the investors' perceptions of the note as a result of the circumstances surrounding its issuance.

273. Some commentators believe that the plan of distribution factor will in fact determine the instrument's status in many instances. See, e.g., Schneider and Cohen, supra note 253, at 195-96.

274. Some commentators argue that the Reves' factors are similar to the Howey factors and therefore, because all factors of the Howey test must be met, all factors of the Reves test must also be met. See Gordon, supra note 51, at 393-98; Steinberg, supra note 186, at 679. Courts may find resemblance to a listed non-security for other reasons, but to be consistent with Reves, they will likely limit their written opinions to the four Reves' factors. See Schneider & Cohen, supra note 253, at 199.

275. Reves, 110 S. Ct. at 955.

276. See infra notes 286-88 and accompanying text.

277. Reves, 110 S. Ct. at 954.

278. See supra text accompanying notes 221-31.

279. Reves, 110 S. Ct. at 954.

280. Id.
To Be or Note to Be a Security

establish the requisite federal interpretation. As Chief Justice Rehnquist indicated, when interpreting an ambiguous term, the Court must depend on the common understanding of the term at the time of the statute's creation. Hence, with no federal law to look to, the dissent argued that the Court may defer to state law interpretations for guidance. The interpretations of the majority of state courts revealed that demand notes are considered subject to immediate maturity. Therefore, if the majority had looked to state law for direction, it could have established a federal interpretation that would find demand notes within the exclusion's purview.

The majority's refusal to look beyond the plain meaning of the exclusion left a significant issue unresolved. As Justice Stevens noted in his concurrence, the courts of appeals have construed the exclusion to include solely commercial paper. Furthermore, the Securities and Exchange Commission expressed its interpretation of the exclusion as limited to commercial paper that is prime quality, not ordinarily purchased by the general public, used to finance current operations, and eligible for discounting by the Fed-

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281. In SEC v. Howey Co., 328 U.S. 293 (1946), the Court noted that prior state interpretation had "crystallized" the definition of "investment contract," and it adopted a modified form of those state interpretations. Id. at 298.


283. Id. In Ruefenacht v. O'Halloran, 737 F.2d 320 (3d Cir. 1984), aff'd sub nom. Gould v. Ruefenacht, 471 U.S. 701 (1985), the Third Circuit, after discussing the Howey test, stated "by 1946 it was plain that the definitions in the 1933 and 1934 Acts drew on state law for their content." Id. at 329. The dissent in Reves cited previous Supreme Court cases where the Court relied on state blue sky laws and lower court decisions to determine the scope of the federal securities laws. 110 S. Ct. at 958. In SEC v. C. M. Joiner Leasing Corp., the Court relied on state court decisions in its determination whether interests in oil and gas leases were a type of security. 320 U.S. 344, 352-55 (1943). Again in Howey, the Court was faced with interpreting the definition of the term "investment contract." 328 U.S. at 297. Because the term was neither defined in the Act nor in the legislative history, the majority relied on the prior state law decision for guidance and found that "[b]y including an investment contract . . . Congress was using a term the meaning of which had been crystallized by . . . prior judicial interpretation." Id. at 298.

284. See American Wholesale Corp. v. Bryant, 2 F.2d 31, 32 (5th Cir. 1924); In the Matter of Las Colinas, Inc., 294 F. Supp. 582, 595 (D.P.R. 1968); Peterson v. Valley Nat'l Bank, 102 Ariz. 434, 432 P.2d 446 (1967); Northcutt v. Massie, 201 Tenn. 638, 301 S.W.2d 355 (1957); Hotel Lanier Co. v. Johnson, 103 Ga. 604, 30 S.E. 558 (1898); see Reves, 110 S. Ct. at 957 (citing M. Bigelow, THE LAW OF BILLS, NOTES, AND CHECKS, § 349 at 265 (3d ed. W. Lile Rev. 1928) and 8 C.J. Bills and Notes § 602, n.83 (1916)).

285. Reves, 110 S. Ct. at 955 (Stevens, J., concurrence). See supra text accompanying notes 232-38. Several courts have emphasized that it is the character of the note and the nature of the transaction that determine Securities Act coverage, not its maturity. C.N.S. Enters. v. G. & G. Enters., Inc., 508 F.2d 1354, 1361 (7th Cir.) (citing SEC v. Continental Commodities Corp., 497 F.2d 516, 524-25 (5th Cir. 1974)), cert. denied, 423 U.S. 825 (1975)).
eral Reserve. According to Justice Stevens, such a deep-rooted interpretation "should not be disturbed."

Indeed, the interpretation was not disturbed. It was ignored. The Court evaded the issue by limiting its holding to demand notes. The Court's failure to interpret the exclusion also left unclear whether the presumption of coverage under the Reves' family resemblance test applies to securities with a maturity of less than nine months. Furthermore, although the Court found that the demand notes in Reves fell outside of the exclusion, the Court suggested that some demand notes intended by both parties to mature within the nine month period might fall within the exclusion. The Court, however, failed to supply guidelines for determining under what circumstances those demand notes could be excluded from Securities Acts' regulation. If the Court had otherwise construed the exclusion, the full ambit of issues with respect to short-term notes would have been settled. As a result of the limited holding, the status of notes with a fixed maturity of nine months or less remains uncertain.

VI. Effect On the Corporate Planner

Prior to Reves, with the exception of the Second Circuit, the issuer could take comfort in knowing that his note was not covered under the Securities Acts unless a plaintiff overcame the burden of proving coverage. A presumption of coverage for all notes under the Reves' family resemblance test now shifts a heavy burden to the issuer to show that the note is not a security and therefore not covered under the Securities Acts. The practical effect of this presumption is that some issuers might assume coverage rather than risk violating the registration and antifraud provisions of the Securities Acts. Although Reves' four factors suffer from the same indefiniteness as

287. Reves, 110 S. Ct. at 956.
288. Id. at 955.
289. See id. at 951 n.3 (majority).
290. See id. at 955.
291. Both the commercial/investment test and risk capital test presumed non-coverage. See supra text accompanying notes 135-55.
292. For the small issuer, however, this may not be a viable alternative because of the high cost of complying with the regulations. 15 U.S.C. 77f(b) (1988) (filing fee for registration statements). In addition to the filing fees, issuers incur legal, printing, and accounting fees. See, e.g., WASHINGTON REAL ESTATE INVESTMENT TRUST, REGISTRATION STATEMENT, Pt. II, item 14 (April 25, 1990). Issuers offering notes that are specifically listed as non-securities in Reves' family resemblance test, however, may take comfort in knowing that the notes are not securities.
VII. CONCLUSION

Since the enactment of the Securities Acts, the Supreme Court has struggled with establishing a definitive test to determine an instrument's status as a security. This struggle is partially attributed to the evolution of a vast array of innovative instruments purchased and sold in varying transactions. Beginning with Landreth, the Supreme Court has determined that no single test can encompass all the instruments which necessarily fall under the definition of a "security." Reves v. Ernst & Young established a test tailored exclusively for determining if notes are securities. Adopting a separate test for notes wisely and accurately reflects the inadequacy of attempting to apply uniformly one test to a multitude of distinct instruments. Developing tests that are specifically tailored to particular instruments will provide some degree of certainty in the application of the Securities Acts.

But with respect to notes that seemingly fall within the short-term note exclusion, Reves failed to confront the issue directly. The majority's reasoning was inconsistent with Supreme Court precedent and failed to recognize the contemporaneous understanding of the term "maturity." Moreover, the Court's unwillingness to resolve the longstanding debate over the exclusion's meaning left the status of a large class of notes in a state of uncertainty.

Undoubtedly, Reves alleviated the uncertainty over the appropriate analysis to be employed in note transactions. Although the meaning of the short-term note exclusion is still unclear, the Reves' family resemblance test strengthens the ability to predict whether a note will fall within the Securities Acts' prohibitions. Notwithstanding this decision, the Supreme Court will likely confront the definition of a security again as the markets continue to develop novel instruments.²⁹⁴

Scott D. Museles

²⁹³. As judicial precedent construes or expands the defined categories, the family resemblance test will probably become a more predictable method of analysis for the corporate planner. See Steinberg, supra note 186, at 684.

²⁹⁴. Since the enactment of the Securities Acts, the Supreme Court admittedly has struggled to develop a universal test for determining whether a security exists. Although it was once believed that the Howey test "embodie[d] the essential attributes that run through all of the Court's decisions defining a security," United Housing Found., Inc. v. Forman, 421 U.S. 837, 852 (1975), beginning with Landreth, the Court began to establish tests that were not universal. Instead, the Court created separate tests for different types of instruments. Reves reaffirmed that the Howey test is limited.