California Law Review

Volume 66 | Issue 6 | Article 4

December 1978

United States National Bank of San Diego--Were the Investors Protected

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Recommended Citation

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https://doi.org/10.15779/Z38MN1V

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United States
National Bank of San Diego—
Were the Investors Protected?

The issuance and sale of most securities is governed by the Securities Act of 1933, which requires a registration statement to be filed with the Securities and Exchange Commission (SEC) and a prospectus to be made available to the purchasers and prospective purchasers of the securities whenever securities are sold to the public “directly or indirectly.” Failure properly to provide information required in the registration statement and prospectus subjects the seller to criminal sanctions under section 5 of the Act and to private damage actions under sections 11 and 12 of the Act. Additionally, section 17 provides criminal sanctions for fraud in the sale of any securities.

Bank securities, however, are exempt from the disclosure requirements of the 1933 Securities Act. Trading in the securities of national banks is regulated under the 1934 Securities Exchange Act and enforced by the Office of the Comptroller of the Currency (OCC) as part of the OCC’s general mandate to regulate the operations of national banks. Prior to 1977, OCC regulations required an offering circular to be filed with the OCC and distributed to purchasers when a national bank issued and sold its securities to the public.
The recent case of *Little v. First California Co.* demonstrates the serious problems caused by the exemption of national banks from the 1933 Securities Act. In *Little*, purchasers of the securities of a national bank suffered a loss when, five months after purchase, the bank was forced into receivership. The district court felt that this loss should be compensated and concluded that the OCC regulations together with the antifraud sections of the securities acts provided the purchasers with a private right of action against those involved in the sale.

This Note, while urging the need to protect prospective investors in bank securities, will argue that the decision in *Little* is legally incorrect. First, it is questionable whether the OCC actually has the author-

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§ 16.2 Requirement of offering circular.

No existing national bank shall publicly offer or sell any of its capital debentures and no new national bank shall publicly offer or sell any of its securities unless such securities shall have been made the subject of an offering circular filed in the Office of the Comptroller of the Currency and declared effective.

§ 16.3 Content of offering circular. [omitted]

§ 16.4 Filing of and use of offering circular.

(a) No person on behalf of or for a new or existing national bank shall offer to sell or solicit any offer to buy any capital debenture or note or other securities of a national bank subject to this part being publicly offered by a national bank unless prior to, or at the time of such offer or solicitation, a copy of an offering circular which has been filed pursuant to this part is furnished to the potential purchaser by the person making the offer or solicitation.

(b) No securities of a new or existing national bank subject to this part shall be sold, or confirmation of sale relating thereto be delivered after sale, by, for, or on behalf of the bank unless at the time of sale or prior to such sale, the purchaser of such security has received an offering circular declared effective by the Comptroller of the Currency.

(c) The offering circular shall be used in accordance with this part until the completion of the distribution of the securities. If the distribution is not completed within 12 months from the effective date of the offering circular, an amended offering circular shall be filed and a revised offering circular shall be used in accordance with this part as for an original offering circular. In no event shall an offering circular be used which is false or misleading in light of the circumstances then existing.

(d) Filings shall be made in quadruplicate and may be printed, lithographed, typewritten, or prepared by similar process resulting in clearly legible permanent copies. One copy of all filings made pursuant to this part shall be manually subscribed by the national bank's Chief Executive Officer and Cashier.

§ 16.5 Advertisements. [omitted]

§ 16.6 Sanctions.

The failure to comply with any requirement of this part may result in the withholding of the approval of the Comptroller of the Currency to issue the securities, the withholding of effectiveness of the registration statement, or the taking of such other action appropriate in the circumstances.

The effect of earlier and later promulgated regulations under this section is discussed in text accompanying notes 45-49 infra.

ity to require disclosure of information in the issuance of bank securities. Second, assuming such authority does exist, it is doubtful that a private remedy for violation of OCC regulations may properly be implied under the relevant statute and regulations. Third, it will be seen that implying such a remedy would be impractical since it would require an unwarrantedly broad construction of the Comptroller's regulations. Finally, given the absence of such a private remedy, this Note will discuss the sufficiency of the presently applicable provisions of the securities laws in protecting the bank investor. Concluding that such protection is inadequate, this Note will argue that appropriate legislation is needed, for in the absence of an adequate statutory framework, the ability of the courts to fashion preventive and remedial rules governing the issuance of bank securities is limited.

I

THE LITTLE LITIGATION

In December, 1972, C. Arnholt Smith purchased six million dollars of subordinated capital notes from United States National Bank of San Diego (USNB), of which he was chairman of the board of directors and president. He financed the purchase with a loan from the Valley National Bank of Arizona (VNB) and pledged the notes as collateral for the loan. It was understood by VNB that the loan was to be repaid by the resale of the notes. In April, 1973, VNB returned the notes to Smith at his request; the notes were reissued in smaller denominations bearing the name Efcee & Co., the street name of First California Company (FCC), and were returned to VNB. FCC marketed the notes for an eight percent commission. FCC confirmed the sale of four million dollars of the notes by May, 1973, and VNB delivered the notes to FCC in exchange for the transfer to VNB of the cash proceeds.11

USNB's capital notes were sold without disclosing the material facts that the owner of the notes was C. Arnholt Smith, a controlling person with regard to the bank, and that the financial position of the bank was being investigated by the OCC.12 USNB had a weak capital position caused by improper extension of credit to C. Arnholt Smith and to entities controlled by him. Only five months after the sale of the notes to investors, the bank was forced into receivership by the Federal Deposit Insurance Corporation and sold. The notes became worthless.13 Smith, now facing trial on criminal charges, is unable to repay the four million dollars which plaintiffs paid for the notes.

12. Id. at 92,552.
13. Id.
The named plaintiffs, as representatives of the class of persons who purchased the USNB notes during the period of April through June, 1973, filed suit in United States District Court for the District of Arizona against the underwriter FCC, USNB, Smith, VNB, and others involved in the transaction, alleging violation of the OCC's offering circular regulations and fraud under the Securities Act of 1933, the Securities Exchange Act of 1934, and Arizona's blue sky law. The OCC regulations in effect in 1973 required that an existing national bank provide an offering circular to prospective investors and to the Comptroller of the Currency when it publicly offered or sold its capital debentures. Defendants VNB and Smith moved to dismiss this count on the ground that no private right of action arises from violation of the regulation, arguing that not every statutory duty gives rise to a private right of enforcement and that the claim for a private action was even more attenuated when, as here, it was based upon a regulation and not the statute.

In a preliminary memorandum opinion, the district court held that the OCC regulation requiring an offering circular was a valid implementation of the OCC's authority to "control the securities" of national banks. Further, the court held that the regulation gives rise to a private right of action to enforce its provisions. Additionally, the Little court concluded that defendant FCC was liable for fraud in the sale of the bank notes under both section 17(a) of the 1933 Act and rule 10b-5 promulgated under section 10(b) of the 1934 Act.

II

THE INADEQUACY OF PROTECTION FOR BANK INVESTORS UNDER THE EXISTING REGIME

The Little court's finding of a private remedy under the OCC's regulations will not withstand analysis. First, the OCC's authority to issue the regulations is suspect. Second, even if the regulations were validly issued, the underlying statutes do not evidence the required legislative intent for implying a private remedy. Finally, because of the imprecision of the OCC regulations, any implication of a private remedy would produce at best haphazard protection for bank investors.
A. The Comptroller's Authority to Regulate the Public Issuance of Securities by National Banks

The Little court found that the OCC's authority to require an offering circular could be implied from the provisions of several statutes. First, the court interpreted the exemption of banks from the 1933 Securities Act as supporting the assumption that "Congress intended the Secretary of the Treasury or a subsidiary officer to control the securities of banks." Second, the court found statutory authority for OCC regulation in section 12(i) of the Securities Exchange Act of 1934 which gave the OCC power to issue regulations governing trading in bank securities. Finally, the court noted that the OCC was empowered to issue the regulations in question under the general authority given it by the banking laws.

1. The Meaning to be Inferred from Congress' Exemption of Banks from the Provisions of the 1933 Securities Act

An examination of the 1933 Securities Act itself gives no indication of Congress' purpose in exempting banks from its provisions. The language of the exemption leads to no inference that the Comptroller may issue regulations which parallel the provisions from which bank securities are made exempt. An examination of the legislative history is no more fruitful. The statute was rushed through Congress during the early days of the New Deal; nearly all of the drafting and redrafting that took place was done in the "back room" rather than in committee or on the floor of either House of Congress; and recorded comments about the exclusion of banks from the operation of the new provisions are sparse. If any meaning can be gleaned from the few comments that were made, it is that Congress assumed, rather than mandated, that banks were or would be regulated by agencies other

22. Id.
26. Id.
than the FTC or the newly formed SEC. This sparse legislative history does not permit an inference that Congress intended the Department of the Treasury to issue securities regulations for banks.

2. The Effect of Section 12(i) of the Securities Exchange Act of 1934

The Little court also found authority for the OCC regulations in section 12(i) of the 1934 Securities Exchange Act, which then empowered the OCC to administer certain sections of that Act with respect to national banks.

Section 12(i), however, refers explicitly to specifically designated sections of that same Act. Therefore, the power of the OCC to promulgate the regulations requiring an offering circular when a national bank publicly offers or sells its debentures can only be derived from the powers vested in the Comptroller to enforce the named provisions in the 1934 Act or to execute his functions under those provisions. In the face of the express exemption of bank securities from the 1933 Act, it seems unlikely that, in the 1934 Act, Congress would use such an indirect method to authorize the Comptroller to regulate the area. Even if it is argued that some regulation of the issuance of bank securities is "necessary for the execution" of the 1934 Act, there is no basis for interpreting the 1934 Act as requiring or justifying the application of extensive provisions similar to those of the 1933 Act to bank securities contrary to the express congressional exemption.

The 1975 amendment to section 12(i) does not suggest a different result. Although it does indicate that Congress intended for regulation of the trading in the securities of national banks to be "substantially similar" to the regulation of trading in other securities under the 1934 Act, it does not establish the extent to which the regulation of new

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29. Id. See Butera, supra note 27, at 442-50. See also Landis, supra note 27, at 44-46. The few words of Professor Loss on the subject similarly indicate that Congress assumed that securities regulation with regard to banks would be carried out by other agencies. See 1 L. Loss, Securities Regulation 560-66, 708-14 (2d ed. 1961); 4 L. Loss, supra, at 2459-63 (2d ed. Supp. 1969).


In respect of any securities issued by banks which are insured by FDIC . . . . the powers, functions, and duties vested in the [Securities and Exchange] Commission to administer and enforce sections 12, 13, 14(a), 14(c), 14(d), 14(f), and 16 . . . . are vested in the Comptroller of the Currency [who] shall have the power to make such rules and regulations as may be necessary for the execution of the functions vested in [him] as provided by this subsection.

31. A 1975 amendment of this section did not change its basic meaning by adding the following sentence:

In carrying out [his] responsibilities under this subsection, [the Comptroller] shall issue substantially similar regulations to regulations and rules issued by the [Securities and Exchange] Commission under sections 12, 13, 14(a), 14(c), 14(d), 14(f), and 16.

issues is “necessary for the execution” of the OCC’s role in overseeing their trade. That question remains unexplored. Certainly it is difficult to argue that the intent to have bank securities regulated similarly to other securities under the 1934 Act is a basis for drafting regulations as precise and extensive as the provisions of the 1933 Act. Thus an examination of the exemption itself, its history, and also the history of the 1934 Act indicates at best only tenuous support for the authority of the OCC to regulate new issues of securities of national banks.

3. Authority to Regulate Bank Securities Conferred by the Banking Statutes

The district court relied on section 24 of the banking law, which mandates the OCC to regulate dealing in securities by national banks. Section 24 prohibits commercial banks from engaging in investment banking and from buying or selling securities either as underwriter or for their own accounts. Since the provision says nothing about the issuance by a bank of its own stocks or bonds, section 24 does not support the Comptroller’s authority to regulate securities offerings by banks. Although not relied on by the Little court, section 57 of the same title, giving OCC the power to approve an increase of capital of a national bank, seems more directly to concern the authority of the OCC

33. 12 U.S.C. § 24 (1976) defines the general corporate powers of national banks and limits the extent to which national banks may engage in dealing and underwriting investment securities. That section is too long to reproduce here. The portion which relates to sales of securities in which a national bank may be involved provides as follows:

§ 24. Corporate powers of associations
Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

. . . .

Sixth. To prescribe, by its board of directors, bylaws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. . . The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe.
34. Id.
35. 12 U.S.C. § 57 (1976) provides:

§ 57. Increase of capital by provision in articles of association
Any national banking association may, with the approval of the Comptroller of the Currency, and by a vote of shareholders owning two-thirds of the stock of such associations, increase its capital stock to any sum approved by the said comptroller, but no increase in capital shall be valid until the whole amount of such increase is paid in and
to regulate securities offerings of banks. The plain language of the provision, however, as well as its placement among sections relating to the corporate powers of banks,\(^3\) indicates a primary focus upon the protection of existing shareholders, and the safeguarding of the capital structure of the bank itself for the protection of depositors, rather than the protection of prospective investors as such.\(^3\) Nonetheless, reading the provisions of the banking law in conjunction with Section 12(i) of the 1934 Securities Exchange Act,\(^3\) which may require some regulation of distributions of national banks' securities in order to effect the regulation of trading in such securities, does suggest that the OCC has some authority to regulate the issuance and public distribution of the securities of national banks. But Congress' repeated reconsideration of the securities acts and continued retention of the exemption of banks from the 1933 Act do not support the Little court's conclusion that the far-reaching regulation at issue was within the OCC's power.

**B. Availability of Private Remedies for a Violation of the Comptroller's Regulations**

The district court in Little found that the OCC regulations gave rise to a private right of action by investors in order to enforce the regulations.\(^3\) The court based this conclusion on the securities provisions of section 24 of the banking laws and on the language of the OCC regulations themselves.\(^4\) The court found it "apparent that Congress intended to limit carefully national bank involvement in securities, in conjunction with the general protection offered investors in the 1933


\(^3\) Id. § 57. Of course, investors are shareholders and in this sense the statute is aimed at investor protection. Thus, it can be argued that protection of prospective investors is one of the purposes of the OCC's power to approve capital increases, albeit peripheral to the central purposes of safeguarding capital soundness and protecting depositors and existing shareholders. Nevertheless, it requires a stretch to find authority for securities regulation by the OCC in the peripheral purposes of the provisions of the banking law.


\(^3\) Little I, [1974-75 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,745 at 96,470.

\(^3\) Id.
and 1934 Acts." Since investor protection was the broad purpose of the securities acts, the court held that the coordinate regulations of the OCC must have the same purpose. In order to effectuate this purpose, the court found a right to private actions implied under the OCC regulations.

The *Little* court was unjustified in concluding that implication of a private remedy was appropriate in order to effectuate the OCC's regulatory purposes for two reasons. First, it is unsupportable to imply a private right of action to implement an administrative purpose because the implication of a private right of action depends on the intent of the legislature to make such a right available when it enacted the underlying statute. Any argument that the regulations themselves provide the basis for an implied private right of action only begs the question of legislative intent.

Second, the history of this regulation belies the argument that the prospective investor was intended to be individually protected. Prior to 1971 the regulation had expressly stated that no private cause of action might accrue under its provisions. In 1971 this prohibition was deleted. However, in 1977 the offering circular requirement was again amended, this time to require that "no bank shall, directly or indirectly, offer . . . or sell any security of which it is the issuer unless the offer . . . or sale is made through the use of an offering circular." Although this revision does not appear to have changed the substance of the regulation's requirement that an offering circular be provided, it is not clear whether the purchaser is now the intended beneficiary of the regulation. The deletion of any provision for sanctions at the same time further obscures the identity of the intended beneficiary of the regulation. While the offering circular requirement in force at the time the *Little* action arose appeared to envision the prospective investor as its

41. *Id.* at 96,469.
42. *Id.* at 96,470.
43. *Id.*
47. 12 C.F.R. § 16.3 (1978) (emphasis added). The regulation has also been substantially modified to require, under § 16.6 as amended, more detailed information than previously has been required to be disclosed. Nevertheless, the new regulations make no provision for the application of sanctions.
48. *Id.*
particular beneficiary, both the earlier provisions and later amendments create a contrary inference. The history of this regulation suggests that the OCC never intended a private right of action.

The uncertain inference to be drawn from the administrative history serves to emphasize that implication of private rights should be based upon legislative, not administrative, intent. Determination of whether a private right of action may be implied from the Comptroller's regulations here at issue presents a special problem since those regulations are not directly appended to any particular statutory section. As previously discussed, section 57 of the banking law may provide some undefined authority for the OCC to regulate the sale of bank securities. But the ambiguous authority which may exist in section 57 does not meet the criteria established by the Supreme Court for implying a private right of action.

I. The Supreme Court Test for Implying Private Remedies

Implying a private remedy in a statute depends on the extent to which the private remedy was intended by the legislature when it enacted the underlying statute. If the statutory intent with regard to the existence of private remedies is unclear, as is often the case, the court may attempt to discern the purposes of the statute and determine whether a private remedy may be implied in order to effectuate those purposes. In the securities area, despite the broad purpose of the securities laws to protect investors, not every provision of those acts has been held to give rise to a private remedy when none is expressly provided in the statute.

Perhaps the most expansive approach to implied private remedies

49. 12 C.F.R. § 16.4 (1977). See note 9 supra. Section 16.4 of the OCC regulation then in effect required that an offering circular be furnished to purchasers and potential purchasers prior to or at the time of any offer to sell or solicitation of any offer to buy any covered security (i.e., debenture) being publicly offered by an existing national bank.

50. See text accompanying note 33 supra. The Comptroller has routinely recited "the authority of the national banking laws, . . . 12 U.S.C. 1 et seq." as authority for this regulation. See 12 C.F.R. § 16.1(a) (1977) (quoted in note 9 supra).

51. See text accompanying notes 33-35 supra.


For commentary on the propriety of implied private remedies under the securities laws, see generally 3 L. Loss, supra note 29, at 1784-85 (2d ed. 1961); R. Jennings & H. Marsh, Securities Regulation 863-64 (4th ed. 1977).
under the securities laws was articulated in the *Borak* case, in which the Supreme Court said, "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the Congressional purposes." More recently, however, the Court has reconsidered the rule for the implication of private remedies and, although adhering to *Borak*’s reliance upon congressional purpose and upon the necessity of a private remedy in effectuating that purpose, has applied the *Borak* test more stringently than before. The purpose of section 14(e) of the 1934 Act was narrowly construed in *Piper v. Chris-Craft Industries, Inc.* as providing especial protection to tender-offerees but not as extending to tender-offerors. Thus, the Court looked to the most specifically intended beneficiaries of the statute in delineating congressional purpose.

*Piper* relied upon the Court’s earlier discussion of the implication problem in *Cort v. Ash*, where the Court identified four factors as relevant in determining whether a private remedy is implicit in a statute that does not expressly provide one: first, whether the plaintiff is “one of the class for whose especial benefit the statute was enacted’”, second, whether there is “any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one”, third, whether it is “consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff,” and fourth, whether such an action is one “traditionally relegated to state law.”

In sum, the basis for implying a private remedy is that the legislation impliedly intends private enforcement. This approach may be applied broadly to provide private remedies for the general purpose of enhancing public enforcement. Or the approach may be applied more cautiously, to provide a remedy only where the proposed beneficiary of the remedy is intended by the statute to be individually protected. The Supreme Court has taken the narrower view. The *Little* court’s implication of a private right of action under the OCC regulations must be evaluated for compliance with the Supreme Court’s decisions in *Piper* and *Cort*.

55. Id. at 433.
57. Id. at 35-36.
58. Id. at 26-36.
61. 430 U.S. at 38.
62. Id. at 39.
63. Id. at 40.
2. Application of Piper and Cort to the Little Case

In applying the four factors of Cort and Piper to the instant case, the fourth factor—whether the action is traditionally one under state law—should be considered first. In Piper the Court reasoned that although federal securities regulation is pervasive, where a state action is generally available it is appropriate to limit plaintiff to that action and remedy.\(^64\) Thus, in Little, where the district court has held that plaintiff can bring an action under Arizona law against VNB\(^65\) but not against FCC,\(^66\) the plaintiffs should under Piper be limited to an action against VNB under state law, although plaintiffs may sue FCC in federal court. This result, however, would limit plaintiffs' federal claim to a single defendant separately, or would require them to sue FCC in federal court and try to attach the VNB case as one of pendent jurisdiction. It was these jurisdictional difficulties which Congress sought to eliminate by providing a federal remedy under the securities laws.\(^67\) The relatively clear congressional purpose to provide a single forum for the adjudication of securities claims undermines the rationale of the fourth factor in Cort in a situation like that in Little.

On the other hand, the first three factors, all of which focus on legislative intent, are clearly contrary to the Little court's conclusion. Even assuming that section 57 of Title 12 gives the most direct support for OCC regulation, the language of that section does not supply any evidence that Congress intended to provide a private remedy to investors who are sold unregistered bank securities.\(^68\) Standing alone, section 57 seems only to imply that the Comptroller will not approve the capital expansion plans of a national bank where the whole amount of the increase is not paid in.

The banking laws appear to have been intended for the especial benefit of existing shareholders and the safety of depositors rather than for new or prospective investors.\(^69\) Therefore, according to the first part of the Cort test, purchasers of new bank securities would not be entitled to a private remedy. Indeed, with regard to all factors other than the fourth, the Cort v. Ash test as reiterated in Piper demonstrates that it

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\(^64\) Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 40 (1977).


\(^66\) Id. at 92,556.


\(^69\) See text accompanying notes 35-37 supra. See also Clark, The Soundness of Financial Intermediaries, 86 YALE L. J. 1 (1976), which discusses the constituencies served by current regulation of banks. One conclusion reached by Professor Clark is that investors as a constituency are at best indirectly protected.
would be improper to imply a private remedy because the relevant statutes do not manifest the requisite legislative intent.

Thus, section 57, the statutory provision which gives the most support to the Comptroller's claim of authority to require offering circulars of national banks, does not fulfill the Supreme Court's requirements for implying a private remedy against its violation. This provision does not evidence a legislative intent to use a private civil remedy as a means to enforce this section of the banking laws.

C. Difficulties with the Comptroller's Regulations as a Practical Matter

Any attempt by the courts to fashion a remedy based upon the OCC's regulations must necessarily founder. Because the legislative purpose is ambiguous, the regulatory agency itself lacks sufficient guidelines to fashion a remedy that will afford adequate protection. As the Little court acknowledged, "[t]he [OCC] regulations are less rigorous in definition and breadth than the 1933 Act, and often silent where the 1933 Act is precise."70 This imprecision leads to at least two practical difficulties when any court attempts to apply the OCC regulations in a private action. First, as discussed in the last section, it is unclear whether the regulations will in fact protect the plaintiff. Second, in order to do equity under such ambiguous regulations, a broad construction of those regulations will often be required to apply to the case at bar. The Little opinion illustrates the second of these difficulties in its attempt to deal with the first.

The district court was forced to stretch the applicability of the OCC regulations in order to find that defendant FCC was liable as a principal for a violation. The court held that the language of section 16.4(a) prohibiting a sale of notes "on behalf of or for" a bank without an offering circular extended to the sale by the underwriter FCC of notes owned by Smith. The court held further that the public sale of the capital debentures, within months of their private placement, "constituted an indirect public offering" without an offering circular and was prohibited by the OCC's regulation.71 The court so held despite the lack of any contractual relationship or other agreement between FCC and the issuer, USNB, concerning the sale of the USNB notes.

In holding FCC liable, the court relied upon SEC v. Chinese Consolidated Benevolent Association, Inc.72 In that case, involving a sale of unregistered bonds, the Second Circuit held that if the solicitation or

71. Id. at 92,553-54.
sale was for the benefit of the issuer in connection with the distribution of securities, the lack of a contractual relationship between seller and issuer would not prevent a finding that the seller had "sold for" the issuer and thereby become liable as an underwriter. Following the reasoning of the court in Chinese Consolidated Benevolent Association, the Little court emphasized that "[t]he investor-protective policy of the Comptroller's regulations can also best be effectuated by a broad definition of 'on behalf of or for' a national bank . . . . Otherwise [the] beneficial purposes of the regulations are vitiated by a simple two-step transaction."73

The court's construction of the OCC regulations is unwarrantedly broad. Chinese Consolidated Benevolent Association is a case arising under the 1933 Securities Act.74 Everyone who deals with a security covered by that Act knows of potential liability and is alert to guard against it.75 The Little court, by disregarding the lack of authority of the OCC to issue regulations and then by interpreting those regulations as if they carried the same meaning as do the congressionally enacted securities laws, has imported those laws wholesale into the banking laws. Yet it has just been shown, as the court itself acknowledged,76 that the language of the regulations with which the court was dealing is much less precise than that of the securities laws. The extent of potential liability under the 1933 Act has been explored and clearly defined by SEC regulations and by the courts. By contrast, the rules applying to bank securities are relatively inchoate and recent amendments to the Comptroller's regulations have not clarified them.77 The certainty of application of the 1933 Securities Act and the accompanying benefit of salutary compliance by issuers simply cannot be duplicated, as the Little court sought to do, by the extension of liability to anyone who sells a bank security to the public under the imprecise OCC regulations. Since duties of care and secondary liability similar to that created by the 1933 Securities Act are not specifically created with regard to bank securities, potential defendants are unfairly surprised by the sudden wholesale application to them of such duties.

Moreover, at the time the Little suit arose, the OCC regulations did not even address indirect public offerings,78 in contrast to the provi-

74. 120 F.2d at 738-39.
75. 3 L. Loss, supra note 29, at 1684-92.
76. See text accompanying note 68 supra.
77. See text accompanying notes 45-49 supra.
78. 12 C.F.R. § 16.4 (1977) (quoted in note 9 supra). The regulations as recently amended, however, do use the "direct or indirect" language. See text accompanying note 47 supra.
sions of the 1933 Act.\textsuperscript{79} Thus, the district court was forced to construe broadly the regulations in order to provide coverage of an area where the court believed the security laws recognized a need for protection but where even the OCC had not yet acted.

Such a broad construction may result in liability in areas outside the scope of regulation intended by Congress. Additionally, it will create imprecision and uncertainty in the regulation of issuances of bank securities. These practical difficulties militate against any implication of a private civil remedy under the OCC regulations.

III

REMEDIES AVAILABLE UNDER THE SECURITIES LAWS

Because the OCC regulations are not sufficient to provide the same type of protection for the potential investor in bank securities that the registration and prospectus requirements of the 1933 Act provide for investors in other types of securities, investors in bank securities must look elsewhere for protection. Although the \textit{Little} court found liability under the antifraud provisions of the securities acts,\textsuperscript{80} adequate protection is not provided by those sections of the law alone. In light of the inadequacies of the antifraud provisions, legislative action is needed to assure protection for prospective investors in bank securities.

A. \textit{The Inadequacy of Regulation by Antifraud Provisions of the 1933 and 1934 Acts Alone}

The protection under the antifraud provisions of the 1933 and 1934 Acts does not appear sufficient to fill the gap left by excluding the issuance of bank securities from the registration and prospectus requirements of the 1933 Act. This gap results from differences in both purpose and function of the two acts\textsuperscript{81} which have led to differences in the scope of their remedies.

The 1934 Act seeks to insure fair and honest trading in securities.\textsuperscript{82}

\textsuperscript{79} See, e.g., The Securities Act of 1933, § 5, 15 U.S.C. § 77e (1976). The basic prohibitions of section 5 are incorporated into the other substantive and sanction provisions of the Act.

\textsuperscript{80} \textit{Little II}, [1971-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,225, at 92,552.

\textsuperscript{81} As Professor Loss has pointed out, "[w]hereas the 1933 act is concerned primarily with the distribution process, the 1934 act has to do with post-distribution trading." 1 L. Loss, \textit{supra} note 29, at 131-32. Professor Loss asserts that the four basic purposes of the 1934 Act are: "to afford a measure of disclosure to people who buy and sell securities; to prevent and afford remedies for fraud in securities trading and manipulation of the markets; to regulate the securities markets; and to control the amount of the Nation's credit which goes into those markets." \textit{Id}.

\textsuperscript{82} Schoenbaum v. Firstbrook, 405 F.2d 200 (2d Cir. 1968); Smolowe v. Delendo Corp., 136 F.2d 231 (2d Cir. 1943). The bulk of litigation brought under section 10(b) of the 1933 Act has come under rule 10b-5, 17 C.F.R. § 240.10b-5 (1976). 3 L. Loss, \textit{supra} note 29, at 1259-64. For a discussion of the purpose and scope of the Exchange Act and rule 10b-5, see Blue Chip Stamps v. Manor Drugs, 421 U.S. 723 (1975).
It imposes disclosure rules and standards of behavior upon corporate insiders, brokers, dealers, exchanges, and investment advisors in an effort to govern the relationships between these parties in the post-distribution market.\(^3\) Section 10(b) of that Act prohibits fraudulent acts in the purchases and sales of securities. In keeping with the 1934 Act's purpose of preventing manipulation and fraud in the trading markets, the remedies provided under section 10(b) and SEC Rule 10b-5 have been held to apply only where a fairly high level of culpability can be shown. In *Ernst & Ernst v. Hochfelder,*\(^4\) the Supreme Court held that a showing of negligence is not sufficient to hold a defendant liable for damages in a private action under section 10(b) and rule 10b-5. Similar limitations exist in other provisions of the Exchange Act.\(^5\) Thus, the

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84. 425 U.S. 185 (1976). Although the Supreme Court has not ruled on the issue, several lower courts have held that a showing of recklessness will suffice for imposition of private liability under rule 10b-5. The Court of Appeals for the Second Circuit has long held that recklessness is sufficient to establish scienter. See Lowenschuss v. Kane, 520 F.2d 255 (2d Cir. 1975); Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir.), cert. denied, 414 U.S. 910 (1973); Lanza v. Drexel & Co., 479 F.2d 1277 (2d Cir. 1973) (en banc); Cohen v. Franchard Corp., 478 F.2d 115 (2d Cir.), cert. denied, 414 U.S. 857 (1973); Shemtob v. Shearson, Hammill & Co., 448 F.2d 442 (2d Cir. 1971); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968) (en banc) (Friendly, J., Concurring), cert. denied, 394 U.S. 976 (1969). That position has been reaffirmed since Hochfelder. See Poloron Prod., Inc. v. Lybrand Ross Bros. & Montgomery, 72 F.R.D. 556 (S.D.N.Y. 1976).


85. Section 9 of the Securities Exchange Act by its terms requires a showing of purpose. Section 18, which provides civil remedies for violation of the registration provisions, has rarely been applied. 3 L. Loss, *supra* note 29, at 1746–47. For a discussion of the purpose and scope of the Exchange Act and rule 10b-5, see Blue Chip Stamps v. Manor Drugs, 421 U.S. 723 (1975).
most salient provisions of the 1934 Act provide remedies only where culpable conduct, amounting to fraud, can be shown.

Since the 1934 Act only protects investors against fraudulent conduct, it leaves the investing public unprotected against losses caused by negligently provided misinformation. It does not demand that issuers exercise care nor provide investors with a remedy if issuers do fail to exercise care.

The gap in protection of investors in bank securities is not filled by section 17(a) of the 1933 Act. Section 17(a) prohibits fraud in the offer or sale of any security. Since section 17(a) prohibits a fraud, it is likely that the courts will require a showing of culpable conduct before imposing liability. Additionally, the propriety of private remedies under section 17(a) has been a matter of disagreement among the courts. Many courts have been reluctant to imply a private remedy under section 17(a) since the 1933 Act provides express private remedies under other sections. Thus, section 17(a) does not significantly enhance a plaintiff's protection against negligent misinformation.

B. The Preventive Effect of the 1933 Act Is Necessary to Protect Bank Investors

The purposes and functions of the 1933 Securities Act are broader than merely preventing fraud. As stated in its preamble, the purposes of the Act are “to provide full and fair disclosure of the character of securities sold . . . and to prevent fraud in the sale thereof.” The ultimate goal of the 1933 Act is investor protection; effective disclosure is merely a means to that end. Section 5 of the Act is the key disclosure provision. It prohibits the offer or sale, transmittal or delivery of a security through the channels of interstate commerce without the disclosure of certain information in a registration statement.

The requirements of section 5 are bolstered by private civil reme-
dies under sections 11 and 12. Section 11 imposes liability upon designated persons for material statements in a registration statement which are false and misleading, and for material omissions. Section 11 divides potentially liable parties to securities transactions into two groups: persons who are in a position to know material inside information, because they are in positions of responsibility with regard to the issue or the issuer; or persons who are in a position adverse to the issuer, so that they may demand disclosure of material information. Liability attaches unless the designated persons can establish that they had, after reasonable investigation, reasonable grounds to believe, and did believe, that the issuer's statements were accurate and complete. The standard is basically a negligence standard, and enforces a duty of care in favor of all public investors against persons in a position to ensure the disclosure mandated by the Act.

Additionally, section 12(1) imposes absolute liability in favor of the purchaser on any seller who sells an unregistered security covered by the Act. Section 12(2) imposes liability absent a showing of diligence upon the seller of any security sold by means of a material misstatement or omission either in a prospectus or in oral communication.

Thus, sections 11 and 12, unlike the antifraud provisions of the securities acts, provide a remedy to an investor injured by negligently provided misinformation. Moreover, sections 11 and 12 serve a more important function of providing an incentive for issuers and other persons in a position to know or discover material information to exercise reasonable care in the dissemination of that information. Professor Loss has called this the in terrorem effect of the 1933 Act. In practice, the possibility of civil damages or injunctive relief under the 1933 Act serves as an effective weapon in enforcing the duties of care imposed on designated persons by the Act.

The exclusion of bank securities from the registration and prospec-
tus requirements of the 1933 Act and from the civil remedies designed to effectuate those requirements results in inadequate protection for investors in bank securities. There is no incentive for issuers of bank securities to be diligent when providing information to these investors, and there is no express sanction against those in a position to discover material information about the securities to be sold for injuries caused by negligently provided, incorrect information. The protections given bank investors by the antifraud provisions of the 1933 and 1934 Acts cannot fill the gap in protection left by this exclusion. Absent common law duties of care running between those in a position to discover material information and investors, the courts will be unable to apply a negligence standard without legislative support. The Securities Act of 1933 was passed to avoid such difficulties. There is a need for legislation extending the protection of the 1933 Act to investors in bank securities because the remedies provided by the current laws are inadequate.

CONCLUSION

The facts of Little presented an obvious case of injustice and injury which the district court wished to remedy. Nonetheless, the court was on very weak doctrinal ground when it implied a private right of action under the OCC regulations for the injured purchasers of the USNB bank securities. The regulations upon which the remedy was based were issued under rather dubious statutory authority. Even if such regulations could be supported by the relevant statutes, it does not appear that the underlying statutes exhibit the necessary legislative intent for implying a private civil cause of action. Moreover, the imprecision of the OCC regulations makes implication of a private action unwise because the widespread application of such liability may result in haphazard treatment of instances of nondisclosure depending on the apparent equities of the plaintiffs' case.

Absent the type of remedies which the Little court implied, purchasers of bank securities are inadequately protected by current securities laws. In contrast, the structured duties of care and disclosure which the 1933 Act requires in the issuance of most securities, to which issuers and underwriters of bank securities are not now subject, afford investors the protection of two groups of careful intermediaries, and prevent the issuance of stock or debentures which are so weak they cannot withstand the scrutiny which disclosure will allow. The same type of

99. See 1 L. Loss, supra note 29, at 560.
100. Id.
101. See text accompanying note 92 supra.
102. 3 L. Loss, supra note 29, at 1784-85, 1831.
investor protection is needed in the issuance of bank securities. When Congress passed the 1933 Securities Act, it was under the impression that the issuance of bank securities was, or would be, subject to similar legislation. That has never been the case. Congress should now correct the oversight.

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