American Securities versus Russian "Securities": Caveat Emptor

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*The term "valuable paper" (*tsennaya bumaga*) is at the core of Russia's legal system to regulate capital markets in the Russian Federation. In American legal and economic literature, the term "valuable paper" traditionally is translated as "security" and Russian legal and economic literature translates the term "security" as "valuable paper." While some similarities can be found between the two terms, there are significant differences in what is understood by the term "valuable paper" and by the term "security" in American and Russian legal systems and the types of financial instruments that fall within their scope. This Article is dedicated to the comparative analysis of the concepts of "security" and "valuable paper" and their types, which is preceded by a brief examination of the content of these concepts in American and Russian law. The author comes to a conclusion that not one of the instruments deemed a "security" in U.S. legislation would be considered a "valuable paper" in Russian legislation. On the other hand, the following types of "valuable papers" would be considered "securities" in the U.S. law: stocks, certain types of bonds issued by legal entities, certain types of government and municipal bonds, certain types of "other government (municipal) valuable papers," certain types of notes, and option certificates for those valuable papers which are considered "securities." The author evaluates the advantages and disadvantages of the current Russian and American concepts and suggests ways in which these concepts could be further developed and incorporated into current legislation.*

I. INTRODUCTION

The term "valuable paper" (*tsennaya bumaga*) is at the core of Russia's legal system to regulate capital markets in the Russian Federation.[1] In U.S. legal and economic literature, the term "valuable

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1. "Valuable paper" is a literal translation of the Russian term *tsennaya bumaga*: *tsennaya* is "valuable"; *bumaga* is "paper."

paper" is traditionally translated as "security,"[2] and in Russian legal and economic literature, the term "security" is translated as "valuable paper."[3] While some similarities can be found between the two terms, there are significant differences in the understanding of "valuable paper" in Russia and the understanding of "security" in the United States. There are also differences in the types of financial instruments that fall within their respective scope. Moreover, certain types of Russian "valuable papers" and certain types of American "securities" do not have any direct analogy in the United States or Russia, respectively. Finally, not all types of Russian "valuable papers" could be considered as "securities" under U.S. law, although they may have similar names to American securities.

This Article is dedicated to the comparative analysis of what is understood by the terms "security" and "valuable paper" and the various types of "securities" and "valuable papers" that exist. This Article will begin with a brief examination of the content of these concepts in U.S. and Russian law. The study of the various types of "securities" and "valuable papers" will focus on determining which types of American "securities" fall within the scope of a "valuable paper" and which types of Russian "valuable papers" fall within the scope of a "security." This analysis has immense practical value because the findings of this study will be applicable to the development of the Russian doctrine of "valuable papers" and to the improvement of current legislation governing Russia's capital markets.

Until fairly recently, this doctrine was similar to the early twentieth-century German doctrine of *Wertpapiere* based upon the idea of "incorporating the legal right into the document."[4] However, the emergence of the concepts of "nondocumentary valuable papers" and "emissive valuable papers," introduced in the mid 1990s under Part I of

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2. *See, e.g.*, J. Robert Brown, Jr., *Order from Disorder: The Development of the Russian Securities Markets*, 15 U. PA. J. INT'L BUS. L. 509 (1994); *Civil Code of the Russian Federation, Part I*, *in* RUSSIA & REPUBLICS LEGAL MATERIALS 81-84 (John N. Hazard & Vratislav Pechota eds., 1997); John T. Connor, Jr., *Developments in Russia's Securities Markets*, *in* A LEGAL GUIDE TO DOING BUSINESS IN RUSSIA AND THE FORMER REPUBLICS OF THE U.S.S.R. 69, 74-76 (Aviva Yakren ed., 2000).

3. *See, e.g.*, GRAZHDANSKOYE Y TORGOVOE PRAVO CAPITALISTICHESKIKH GOSUDARSTV [CIVIL AND COMMERCIAL LAW OF CAPITALIST STATES] 208 (1993); RYNOK TSENNYKH BUMAG Y EGO FINASOVYE INSTITUTY [VALUABLE PAPERS MARKET AND ITS FINANCIAL INSTITUTIONS] 380-86 (V.S. Torkanovsky ed., 1994).

4. *See, e.g.*, M.M. AGARKOV, UCHENIE O TSENNYKH BUMAGAKH [THE THEORY OF VALUABLE PAPERS] 173 (2d ed. 1994) (quoting H. Brunner, *Die Wertpapiere*, *in* ENDEMANN I HANDBUCH DES DEUTSCHEN HANDELS-SEE-UND WECHSELRECHTS 19, B.II (1882); E. Jacobi, *Die Wertpapiere*, *in* Bürgerlichen Recht, Ehrenberg's HANDBUCH DES GESAMTEN HANDELSRECHTS 125, B.IV (1917)).

the new Civil Code of the Russian Federation (GK RF) enacted in 1994,[5] as well as the federal law "On the Valuable Papers Market" (the Valuable Papers Market Law)[6], signalled a departure from the traditional model of *Wertpapiere* towards the U.S. concept of "security." In comparing the concept of "security" to that of the "valuable paper," one is able not only to evaluate the advantages and disadvantages of the current Russian concepts, but also to envisage ways in which these concepts could be further developed and incorporated into current legislation.

Moreover, when one considers the large numbers of American investors purchasing Russian issuers' "valuable papers" and the growing numbers of Russian companies trading on the U.S. securities markets, the findings of this paper could be of significant practical value to both current and future investors. In purchasing a foreign issuer's "security" or "valuable paper," a buyer is more likely to be motivated by economic factors, such as the expected return on the instrument, than the legal characteristics governing the instrument. If the investor is a large institutional investor, company lawyers would automatically be called in to scrutinise the instrument. However, if a small investor were to carry out such an exercise, the expected returns would probably be swallowed up by legal fees. Therefore, small investors have no choice but to take the instrument on trust hoping that it has comparable characteristics to an instrument in their own legal system. Put simply, small investors expect a "bond" to be a "bond" irrespective of whether it was issued in the United States or in the Russian Federation. In fact, until foreign issuers are called upon to perform their obligations, small investors need not worry about the instrument's characteristics. As long as the companies perform their financial obligations, there is no problem. However, problems arise where there is a need to protect investors' rights, particularly in cases where a court action has been brought against foreign issuers for failing to perform their financial obligations. Small investors will be disillusioned when they learn that the rights acquired with the purchase of the "security" or the "valuable paper" are very different from those they anticipated. This is why prudent investors, acting in accordance with the Roman law maxim of *caveat emptor*,[7] will ensure that the actual nature and amount of the rights acquired under this

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5. Federal Law No. 52-FZ of 30 November 1994 "On implementing Part I of the Civil Code of the Russian Federation." Sobr. Zakonod. RF, 1994, No. 32, Item 3302 (Russ.).

6. Federal Law No. 39-FZ of 22 April 1996 "On the valuable papers market." Sobr. Zakonod. RF, 1996, No. 17, Item 1918 (Russ.) [hereinafter Valuable Papers Market Law].

7. "Let the buyer beware. This maxim summarizes the rule that a purchaser must examine, judge, and test for himself." BLACK'S LAW DICTIONARY 222 (6th ed. 1990).

instrument will meet their expectations prior to purchasing a financial instrument from a foreign issuer.

II. THE CONCEPT AND TYPES OF "VALUABLE PAPERS"

GK RF defines a "valuable paper" as a document which certifies, in compliance with the established format and mandatory requisites, property rights that can only be exercised or transferred by the presentation of this document.[8] Drafted in line with the traditional model of a "valuable paper," the formula for a "valuable paper" first denotes the generic term for all "valuable papers" (the document).[9] Second, the formula denotes the specific features that distinguish "valuable papers" from other documents, namely the property character of rights that the "valuable paper" certifies and the requirement to present the document for the exercise or transfer of these rights.[10] In analysing this definition and the other provisions of Chapter 7 of GK RF, one can distinguish four essential factors which characterize "valuable papers": (1) documentality, (2) property character of rights certified by the "valuable paper," (3) presentability, and (4) public authenticity.[11]

The documentality of the "valuable paper" means that the "valuable paper" is a legal document in an established format containing the requisites required by law.[12] These requisites, such as the requirement that "valuable papers" be of a particular format, and including the rights certified by a "valuable paper" and the other prerequisites that "valuable papers" must satisfy, are determined by law or in accordance with the statutory procedures.[13] The "valuable paper" is rendered void when the mandatory requisites are absent or when it fails to comply with the prescribed format.[14]

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8. Grazhdanskii Kodeks RF [GK RF] art. 142(1) (Russ.).
9. *Id.* art. 144.
10. *Id.* art. 144(2).
11. *Id.* arts. 142-149.
12. *See id.* art. 144(1).
13. *Id.*
14. *Id.* art. 144(2). The fact that a document is void as a "valuable paper" because of defects in form or the absence of mandatory requisites does not preclude the use of this document in judicial proceedings as written evidence. *Id.* art. 162(1). In 1997, the Supreme Arbitration Court of the Russian Federation declared that even though a certain document could not be considered a "bill of exchange" because of defects in its form, a separate claim arising out of the existence of this document could be submitted on the basis of the provisions of the Civil Law governing documents that confirm the existence of a debt. *See* section 6 of the Review of the disputes resolution practice related to the utilisation of bills of exchange in commercial transactions (Attachment to the Information Letter of the Supreme Arbitration Court of the Russian Federation of July 25, 1997 No. 18), Vestn. Vyssh. Arb. Suda RF, 1997, No. 10, p. 73.

The right certified by the "valuable paper" is a property right.[15] The term "right" is generally understood in Russian Civil Law as a legally protected limit of permissible behaviour.[16] The "duty," on the other hand, is a legally assured limit of required conduct.[17] Rights, unlike tangible documents, do not exist in any physical form. Russian Civil Law usually subdivides rights into property rights and personal nonproperty rights.[18] Property rights are rights in different types of material goods (things, works, services, and other such material goods), whereas personal nonproperty rights are rights in nonmaterial values (honour, dignity, business reputation, the name of a physical person, the name of a legal entity, a work of art, an invention, or industrial model).[19] "Valuable papers" could certify both property and nonproperty rights.[20] However, the certification of a property right is a mandatory element of any "valuable paper."[21] This characteristic enables us to distinguish between "valuable papers" and legal documents that certify nonproperty rights only. Despite the fact that documents such as birth certificates or passports are of great value to their owners, these are not considered "valuable papers" under Russian law because they confer no property right on the holder.[22]

All "valuable papers" are subdivided into three categories: "bearer valuable papers," "inscribed valuable papers," and "order valuable papers."[23] The right certified by a "bearer valuable paper" belongs to its holder; the right certified by an "inscribed valuable paper" belongs to the person named in it; and the right certified by an "order valuable paper" belongs to the person named in it, who may exercise the right himself or nominate by his instruction (order) another authorized person.[24]

The presentability of a "valuable paper" means that exercising or transferring the rights certified by a "valuable paper" can only be carried out by presenting the "valuable paper."[25] This right appears to be "incorporated" into the document, as if the right is "materialized" in

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15. GK RF art. 142(1).
16. 1 GRAZHDANSKOYE PRAVO [CIVIL LAW] 83 (A.P. Sergeev & Y.K. Tolstoy eds., 1999).
17. *Id.*
18. *Id.*
19. *Id.* at 4-6.
20. GK RF arts. 142-145.
21. *Id.* art. 142(1).
22. *Cf.* 2 G.F. SHERSHENEVICH, KURS TORGOVOGO PRAVA [TREATISE ON COMMERCIAL LAW] 64 (1908).
23. GK RF art. 145(1).
24. *Id.*
25. *Id.* art. 142(1).

paper.[26] At the same time, in a number of cases stipulated by law or in accordance with statutory provisions, in order to exercise or transfer rights certified by a "valuable paper," it is enough simply to present evidence that these rights have been entered into a special registry.[27] This registry may be an ordinary registry or a computerized registry.[28] This provision is an exception to the general rule for transferring or exercising rights certified by a "valuable paper."[29] However, if there were no need to present a "valuable paper" in order to transfer or exercise rights, then there would be no requirement to include this provision in Chapter 7 of the GK RF.[30] Only in exceptional cases would it be necessary to mention the requirement to present a "valuable paper."[31]

The need to present the "valuable paper" is a distinguishing feature of the "valuable paper" that sets it apart from legal documents that are not "valuable papers."[32] Documents that only confirm the existence of a right, regardless of whether a document exists (e.g., a credit agreement executed in written format) cannot be considered a "valuable paper."[33] In such instances, the existence of a document serves only to confirm the existence of a right in the event of a judicial proceeding.[34] Similarly, documents that themselves create a right, but are not required for the right to be exercised (e.g., a written contract to pay a monetary penalty), cannot be considered "valuable papers."[35]

If legislators rigidly adhere to the principle of presentability, holders of the "valuable paper" could be severely penalised. For example, if a "valuable paper" were lost or stolen, the rights certified by this paper would also be lost.[36] However, it would be totally unjustified to demand the issuer of the "valuable paper" to perform the obligation twice, first at the request of the acquirer of the "valuable paper" and second at the request of the former legitimate owner. Legislation in force in the Russian Federation appears to seek a compromise between the interests of the issuers of "valuable papers" and the interests of its legitimate

26. AGARKOV, *supra* note 4, at 178.
27. GK RF art. 142(2).
28. *Id.*
29. *Id.* art. 142(1).
30. *See id.*
31. *See id.*
32. *Id.*
33. *Id.* art. 808.
34. *Id.* art. 162(1).
35. *Id.* art. 331.
36. *Id.* art. 148.

owners.[37] Under GK RF, civil procedure legislation allows the courts to restore the lost rights of the legitimate owner certified by "bearer valuable papers" or "order valuable papers."[38] Regarding "inscribed valuable papers," the law does not require that special court proceedings be instigated to restore the rights certified by an "inscribed valuable paper" because the issuer already knows the identity of the owner.[39] All that is required for the rights to be restored is that the legitimate owner requests a duplicate from the issuer.[40]

Finally, public authenticity of "valuable papers" pertains to the fact that the law severely restricts the grounds on which the issuer of a "valuable paper" may refuse to perform the obligations arising out of that "valuable paper."[41] From the theoretical standpoint, this can be done in one of two ways: by indicating the objections that the issuer of the "valuable paper" may raise against the bearer or, alternatively, by indicating the objections that the issuer may not raise against the bearer. The drafters of GK RF have chosen to adopt the second method,[42] by which an issuer may not refuse to perform an obligation arising out of a "valuable paper" on the grounds that the obligation does not exist or that the obligation is invalid.[43]

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37. *Cf.* V.M. GORDON, AMMORTIZATSIA BUMAG NA PREDYAVITELYA [AMORTIZATION OF BEARER VALUABLE PAPERS] 1 (1918).

38. GK RF art. 148. The procedure itself is prescribed in Chapter 34, *Restoration of rights under bearer and order valuable papers which have been lost (summons proceedings) of the Civil Procedure Code of the Russian Federation of 2002 (GPK RF).* Sobr. Zakonod. RF, 2002, No. 46, Item 4532 (Russ.).

39. *See id.* art. 149(1).

40. *See id.*

41. *See, e.g.*, 1 GRAZHDANSKOYE PRAVO [CIVIL LAW], *supra* note 16, at 229; KOMMENTARIY CHASTI PERVOY GRAZHDANSKOGO KODEKSA ROSSISKOY FEDERATSII DLYA PREDPRINIMATELEY [COMMENTARY OF PART I OF THE RUSSIAN FEDERAL CIVIL CODE FOR ENTREPRENEURS] 183 (1995).

42. Article 32 of the Fundamentals of Civil Legislation of the USSR and the Republics (Fundamentals of Civil Legislation), which was in force in the Russian Federation until the ratification of Part I of GK RF, used both methods simultaneously. On one hand, section 1 of article 32 of the Fundamentals of Civil Legislation prohibited a refusal to perform the obligation arising out of the "valuable paper" on the grounds that the obligation was unfounded or was invalid. On the other hand, section 2 of article 32 of the Fundamentals of Civil Legislation allowed for the refusal to perform the obligation arising out of "valuable paper" if it was proven that the holder of the "valuable paper" had acquired it unlawfully. *See* Fundamentals of Civil Legislation, dated 31 May 1991. Vedomosti s'ezda narodnykh deputatov i verkhovnogo soveta USSR, 1991, No. 26, Item 733 (Russ.).

43. GK RF art. 147(2). For example, if the bill of exchange is presented to its issuer for payment, the issuer may not refuse to pay on the grounds that he had not initially received any money for the issuance of this bill of exchange. Similarly, where the method of payment in another commercial transaction (e.g., sale of goods) was the issue of the bill of exchange, the issuer of this bill may not refuse to pay, even though the main transaction may have subsequently been declared void.

In addition to the "valuable papers" issued in traditional documentary format, Chapter 7 of the GK RF provides for so-called "nondocumentary valuable papers" (*bezdocumentarnye tsennye bumagi*) as a means of recording rights.[44] In cases stipulated by law or statutory procedures, an individual who has obtained a special licence may keep a record of rights certified by inscribed or order "valuable papers," including nondocumentary records of rights that are, for example, in electronic format.[45] The provisions governing "valuable papers" apply also to the rights recorded in this way, unless otherwise stipulated.[46] At the request of the owner of the right, the keeper of the record of rights must issue a document confirming the existence of the right.[47] Law or statutory procedures determine the rights that should be recorded, the procedure for recording the rights, the owners of the rights, the confirmation that the entry has been made in the registry, and the manner with which to carry out transactions with "nondocumentary valuable papers."[48] The official registrar carries out "nondocumentary valuable paper" transactions recording the transfer, the acquisition, and the limitation of rights.[49] The registrar is also responsible for maintaining the official records, along with the confidentiality and accuracy of information presented, and for the recording of all transactions.[50]

Since GK RF explicitly refers to the format for recording rights in an electronic format as a "nondocumentary format," one can conclude that the term "document," used to define "valuable paper," refers only to traditional paper documents and not to the electronic documents used, in conjunction with paper documents, for commercial transactions.[51] In using "nondocumentary valuable papers," there is no longer a need to issue inscribed or order "valuable papers" as separate documents. However, the introduction of the concept of "nondocumentary valuable papers" in Chapter 7 of GK RF does not mean that the documentality of a "valuable paper" is no longer an essential characteristic of the concept of "valuable paper."[52] Irrespective of whether the same generic term is used to describe "nondocumentary valuable papers," GK RF does not place "nondocumentary valuable papers" on an equal footing with

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44. *Id.* art. 149(1).
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.* art. 149(2).
50. *Id.*
51. *Id.* art. 149(1).
52. *Id.* art. 142(2).

ordinary "valuable papers."[53] "Nondocumentary valuable papers" are, however, included within the scope of ordinary "valuable papers," barring possible exceptions.[54] Similarly, while it is not possible to *present* "nondocumentary valuable papers," because no physical document exists, this should not preclude presentability from being considered an essential characteristic of a "valuable paper."[55]

In addition to "valuable papers" and "nondocumentary valuable papers," current Russian legislation also refers to "emissive valuable papers" (*emissionnye tsennye bumagi*).[56] The Valuable Papers Market Law defines an "emissive valuable paper" as a "valuable paper," including a "nondocumentary valuable paper," which simultaneously possesses the following characteristics: (1) certification of a combination of property and nonproperty rights, subject to registration, transfer, and unconditional exercise, in the format and procedure laid down in the Valuable Papers Market Law; (2) placement in issues; and (3) equal amounts and time for the exercise of the rights of the same issue, regardless of the date of purchase of the "valuable paper."[57]

The Valuable Papers Market Law envisages the existence of "emissive valuable papers" in two formats: documentary and nondocumentary.[58] When "emissive valuable papers" are issued in documentary format, the presentation of a duly executed valuable paper certificate identifies their owner.[59] When "emissive valuable papers" are placed in a deposit account, the entry in the deposit account identifies their owner.[60] The issuer of the "valuable paper" produces the "emissive valuable paper" certificate and certifies the combination of rights to a certain number of "emissive valuable papers" inscribed in the "emissive valuable paper" certificate.[61] The bearer of the "emissive valuable paper" has the right to demand performance of the obligation simply by presenting the issuer with the certificate.[62] However, where "emissive valuable papers" are in nondocumentary format, the entry made in the owner's register of "inscribed valuable papers" identifies the owner of the

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53. *Id.* art. 149(1).
54. *Id.*
55. *Id.* art. 142(2).
56. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 2, pt. 1 (Russ.).
57. *Id.*
58. *Id.* art. 2.
59. *Id.*
60. *Id.* art. 2, pt. 8.
61. *Id.*
62. *Id.* art. 2, pt. 11.

"emissive valuable paper."[63] When the "valuable paper" is placed in a depository, the entry made in the deposit account identifies the owner.[64]

As may be seen, Russian legislation defines "emissive valuable papers" as "valuable papers" that differ from ordinary valuable papers by virtue of their issuance only.[65] "Emissive valuable papers" are generally issued in sets of series.[66] Similarly, it is widely held in contemporary Russian legal doctrine that there are essentially no differences between "emissive valuable papers" and "valuable papers."[67] In reality, however, there are significant differences between these two concepts. In theory, there should be a logical correlation between the generic term ("valuable paper") and the specific term ("emissive valuable paper"), in which case an "emissive valuable paper" would possess all four of the essential characteristics of a "valuable paper." However, in reality, "emissive valuable papers" lack *documentality* and *presentability*.

The lack of documentality in "emissive valuable papers" stems from the fact that the Valuable Papers Market Law allows for the combination of property and nonproperty rights to be recognized as "emissive valuable papers," as long as the conditions for acquiring these rights and their circulation contain all of the characteristics that define an "emissive valuable paper."[68] However, under GK RF a "valuable paper" is a document, itself, but not the right certified by the document.[69] Therefore, the concept of "emissive valuable papers" significantly departs from the traditional classification of objects under Russian Civil Law which considers "valuable papers" as "things," and not as "rights."[70]

Furthermore, even for a *documentary form* of "emissive valuable papers," the Valuable Papers Market Law does not envisage their existence in a format of a separate document, as defined under GK RF. When we compare the definition of a "documentary emissive valuable paper" with that of an "emissive valuable paper certificate," we may conclude that the Valuable Papers Market Law makes a clear distinction between an "emissive valuable paper document" and an "emissive valuable paper certificate." While an "emissive valuable paper

63. *Id.*
64. *Id.* art. 2, pt. 9.
65. *Id.* art. 2.
66. *Id.*
67. *See, e.g.*, 1 GRAZHDANSKOYE PRAVO [CIVIL LAW] 320 (E.A. Sukhanov ed., 1998) [hereinafter GRAZHDANSKOYE PRAVO [CIVIL LAW] (Sukhanov)]; 1 GRAZHDANSKOYE PRAVO [CIVIL LAW], *supra* note 16, at 231.
68. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 16, pt. 13 (Russ.).
69. GK RF art. 144(1).
70. *Id.*

certificate" can be issued as a separate document, the Valuable Papers Market Law does not require "emissive valuable papers" to be simultaneously issued as additional documents. From an economic stance, this seems to be perfectly logical, because it allows for a significant reduction in paperwork. In fact, when thousands or even hundreds of thousands of "emissive valuable papers" are issued, the requirement to issue every single "emissive valuable paper" as a paper document would result in an untenable amount of work for the issuer. This burden, however, disappears when the law permits the issuer to issue each purchaser a single certificate indicating the total number of "emissive valuable papers" purchased. This means that "emissive valuable papers," even when issued in a format that complies with the Valuable Papers Market Law, cannot be considered a document under GK RF.

Even though an "emissive valuable paper certificate" is a separate document, it is not recognised legally as a "valuable paper" or an "emissive valuable paper." This is because an "emissive valuable paper certificate" certifies a combination of rights to more than one "valuable paper,"[71] whereas a "valuable paper" certifies the property rights arising from only one "valuable paper."[72] The difficulty in considering the certificate to be a separate "emissive valuable paper" stems from the fact that the Valuable Papers Market Law stipulates that a single certificate certifies the rights to one, several, or all "emissive valuable papers" with a single government registration number.[73] Therefore, the certificate to a single "emissive valuable paper" entitles the holder to a different number of rights from that of a holder of a certificate to several "emissive valuable papers." As a result, certificates within the same issue of "emissive valuable papers" may differ from each other in the number of rights which they certify. This would suggest that an "emissive valuable paper certificate" does not have the third characteristic of an "emissive valuable paper," equal amounts and time to exercise the rights contained within the same issue, regardless of the purchase date of the "emissive valuable paper."[74]

The absence of presentability stems from the fact that the holder of an "emissive valuable paper" can demand that the issuer perform the

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71. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 2, pt. 11 (Russ.).

72. GK RF art. 142(1).

73. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 16, pt. 7 (Russ.).

74. *Id.* art. 2, pt. 1.

obligations arising out of the "emissive valuable paper" solely on the presentation of the "emissive valuable paper certificate."[75] Given that the certificate itself is not an "emissive valuable paper," the possibility of exercising the rights arising out of the "emissive valuable paper" through the presentation of a document that is not an "emissive valuable paper" contravenes the provisions of GK RF, which stipulate that the "valuable paper" itself must be presented for the rights to be exercised.[76]

As we have seen, despite their similarity in terminology, different theoretical concepts underlie "valuable papers," "nondocumentary valuable papers," and "emissive valuable papers." The "valuable paper" is a document which is linked inextricably to the property right certified by this document.[77] The "nondocumentary valuable paper" is an electronic record confirming the existence of the property right.[78] The "emissive valuable paper" is the property right itself and is recorded in either documentary or nondocumentary format.[79]

GK RF provides us with a far from exhaustive list of the type of documents that may be classified as "valuable papers" under Russian legislation.[80] Article 143 of GK RF lists "valuable papers" as "government bonds, bonds, bill of exchange, checks, deposit and savings certificates, bank savings books payable upon demand, bills of lading, stock, privatization valuable papers, and other documents which are classified as valuable papers by the laws on valuable papers or in accordance with the procedure established by them."[81] In addition, GK RF classifies as "valuable papers" warehouse receipts and each of the two parts of a double warehouse receipt: the warehouse receipt and the mortgage certificate (warrant).[82] Also, under government loan contracts the lender may acquire the "government bonds" or other government valuable papers "that certify the right of the lender to receive from the borrower monetary funds loaned to it, or depending on the terms of the loan—other property, stipulated interests or other property rights within the time limits provided by the terms of release of the loan into circulation."[83] Since GK RF provisions relating to government loans apply also to loans

75. *Id.* art. 2, pt. 11.
76. GK RF art. 142(2).
77. *Id.*
78. *Id.* art. 149(1).
79. *Id.* art. 145(1).
80. *Id.* art. 144(1).
81. *Id.* art. 143. The term "laws" as used in GK RF refers to "federal laws." *Id.* art. 3(2).
82. *Id.* art. 912(3).
83. *Id.* art. 817(3).

made by municipal entities,[84] one concludes that the GK RF implicitly envisages the issuance of municipal bonds and "other municipal valuable papers" also to conclude municipal loan contracts.

Neither article 143 of GK RF, nor any of its other provisions, define the term "laws on valuable papers."[85] Can a certain federal law, therefore, be classified as a "law on valuable papers"? The answer to this question is yes, where the name of the law so indicates.[86] The Valuable Papers Market Law,[87] the Promissory Notes and Bill of Exchange Law,[88] and the Peculiarities of the Issuance and the Circulation of Government and Municipal Valuable Papers Law[89] are all "laws on valuable papers." However, the Law on Hypothèque (the mortgage of immovables) which envisages the issuance of "valuable papers" as "mortgage certificates" is more difficult to categorise.[90] When considering the drafting of such legislation and its expediency, it would be difficult to imagine the provisions governing the execution of the mortgage agreement falling under one federal law, while the provisions governing the document certifying the rights of the mortgage holder under that same agreement falling under another. At the same time, unlike the Fundamentals of the Civil Legislation, which classifies bonds, cheques, promissory notes, shares, bills of lading, savings certificates, and other such documents, issued in accordance with the legislation in force, as "valuable papers,"[91] article 143 of GK RF does not make reference to the generic term "legislation," but to the more narrow term of "laws on valuable papers."[92] It would be equally difficult to imagine that the GK RF legislators intended to classify laws such as the Law on Hypothèque (mortgage of immovables), which contain provisions governing valuable papers, as a

84. *Id.* art. 817(5).

85. *See id.* art. 143.

86. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918 (Russ.).

87. *Id.*

88. Federal Law No. 48-FZ of 11 March 1997, "On the promissory note and the bill of exchange." Sobr. Zakonod. RF, 1997, No. 11, Item 1238 (Russ.).

89. Federal Law No. 196-FZ of 29 July 1998 "On the peculiarities of the issuance and the circulation of government and municipal valuable papers." Sobr. Zakonod. RF, 1998, No. 31, Item 3814 (Russ.).

90. Federal Law No. 102-FZ of 16 July 1998 "On hypothèque (mortgage of immovables)." Sobr. Zakonod. RF, 1998, No. 29, Item 3400 (Russ.).

91. Fundamentals of Civil Legislation, dated 31 May 1991. Vedomosti s'ezda narodnykh deputatov i verkhovnogo soveta USSR, 1991, No. 26, Item 733 (Russ.).

92. GK RF art. 143. Civil legislation consists of GK RF and other federal laws, adopted in accordance with GK RF, governing relations indicated in sections 1 and 2 of article 2 of the Code. *Id.* art. 3(2).

"law on valuable papers."[93] From a practical stance, the lack of any clear guidance as to which laws may be considered "laws on valuable papers" could give rise to legal disputes over the legality of documents that are classified as "valuable papers" by laws which do not clearly fall into this category.[94]

The procedure for classifying documents as "valuable papers" is set out in general terms in the Valuable Papers Market Law.[95] This Law grants the Federal Commission for the Valuable Papers Market (Federal Commission) the right to qualify and determine the various types of "valuable papers" in existence under Russian Federal legislation.[96] The Federal Commission makes such decisions in the form of resolutions.[97] Accordingly, it has classified option certificates[98] and investment shares[99] as "valuable papers."

In addition to the "valuable papers" enumerated in GK RF, documents classified as "valuable papers" will continue to be classified as "valuable papers" until new legislation is adopted by various other laws governing "valuable papers" such as the Federal Commission's resolutions; documents classified as "valuable papers" by Presidential Decrees; and Resolutions of the Government of the Russian Federation and of the Government of the U.S.S.R. applicable on the territory[100] of the Russian Federation prior to the entry into force of Part I of the GK RF.[101] This is why housing certificates, classified as "valuable papers" in 1994

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93. Federal Law No. 102-F2 of 16 July 1998 "On hypothèque (mortgage of immovables)," Sobr. Zakonod. RF, 1998, No. 29, Item 3400 (Russ.).

94. GK RF art. 143. In order to eliminate the current uncertainty, it would be desirable to substitute the words "laws on valuable papers" for the word "laws" in GK RF article 143.

95. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918 (Russ.).

96. *Id.* art. 43(2).

97. *Id.*

98. *See* Resolution No. 1 of 9 January 1997 of the Federal Commission for the valuable papers market, "On the option certificate, its use and the approval of the Standards of issuance of option certificates and the prospectus of their emission." Bulletin of the Federal Commission for the valuable papers market, 1997, No. 1(6), p. 1-25, *available at* http://www.fedcom.ru/fcsm/vestnik/vestnik6/pos0197.html.

99. *See* Resolution No. 12 of 12 October 1995 of the Federal Commission for the valuable papers market "On the approval of the Standard Rules of share investment fund" (as amended by Resolution No. 3 of 12 January 1996, Resolution No. 12 of 19 June 1996, Resolution No. 34 of 27 June 1996, Resolution No. 43 of 28 November 1997, Resolution No. 40 of 2 October 1998), *available at* http://www.fedcom.ru/fcsm/vestnik/vest22/post_40.htm.

100. Section 2 of Federal Law No. 52-FZ of 30 November 1994 "On implementing Part I of the Civil Code of the Russian Federation." Sobr. Zakonod. RF, 1994, No. 32, Item 3302 (Russ.).

101. Part I of GK RF came into force on 1 January 1995. *See* Federal Law No. 52-FZ of 30 November 1994 "On implementing Part I of the Civil Code of the Russian Federation." Sobr. Zakonod. RF, 1994, No. 32, Item 3302 (Russ.).

by Presidential Decree, continue to be classified as "valuable papers."[102] However, as of January 1, 1995, documents classified as "valuable papers" by Presidential Decree or by Government Resolution have been in direct contravention of article 143 of GK RF.[103] In fact, neither a Presidential Decree nor a Government Resolution can be considered a "law on valuable papers." Moreover, the Valuable Papers Market Law does not provide for the classification of documents as "valuable papers" by Presidential Decree or by Government Resolution.[104] Consequently, a 1995 Government Resolution that introduced the state housing certificate directly contravenes article 143 of the GK RF.[105] The state housing certificate is a new type of "valuable paper" issued to Russian citizens who have lost their homes due to emergency situations or natural disasters.[106] Likewise, a Presidential Decree that introduced "investment shares" as a new type of "valuable paper" also violates article 143 of the GK RF.[107] However, the passing of Federal Commission Resolution No. 13 on December 12, 1995, providing for investment shares to be classified as "valuable papers" resolved the latter problem.[108]

III. THE CONCEPT AND TYPES OF "SECURITIES"

U.S. law defines "security" in each of the six principal Federal Securities Acts adopted under President Franklin D. Roosevelt's "New

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102. *See* Regulations on the issuance and the circulation of housing certificates, approved by Presidential Decree No. 1182, 10 June 1994, "On the issuance and circulation of housing certificates," Sobr. Zakonod. RF, 1994, No. 7, Item 694 (Russ.).

103. *See* GK RF art. 143.

104. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918 (Russ.).

105. Resolution No. 561 of 7 June 1995 of the Government of the Russian Federation "On government housing certificates, given to citizens of the Russian Federation who have lost their homes as a result of an emergency situation or natural disaster," Sobr. Zakonod. RF, 1995, No. 24, Item 2286 (Russ.); Resolution No. 982 of 9 October 1995 of the Government of the Russian Federation "On the approval of the Procedure for the issuance and the redemption of government housing certificates, given to citizens of the Russian Federation who have lost their homes as a result of an emergency situation or a natural disaster," Sobr. Zakonod. RF, 1995, No. 42, Item 3983 (Russ.). These certificates also are analysed from the perspective of whether they possess the "security" feature, even though, strictly speaking, they would not be deemed "valuable papers" under article 143 of GK RF. Moreover, in all probability, in the event of a dispute over government housing certificates, the court would not classify housing certificates documents as "valuable papers."

106. Section 2 of the Procedure for the Issuance and the Redemption of Government Housing Certificates.

107. GK RF art. 143.

108. Resolution No. 13 of 12 October 1995 of the Federal Commission for the Valuable Papers Market "On the approval of Standard Rules for share investment fund," *available at* http://www.fedcom/ru/fcsm/vestnik/vest22/post_40.htm.

Deal" to regulate the American securities markets.[109] These six principle Acts were: the Securities Act of 1933 (Securities Act),[110] the Securities Exchange Act of 1934 (Securities Exchange Act),[111] the Public Utility Holding Company Act of 1935 (Public Utility Holding Company Act),[112] the Trust Indenture Act of 1939 (Trust Indenture Act),[113] the Investment Company Act of 1940 (Investment Company Act),[114] and the Investment Advisers Act of 1940 (Investment Advisers Act).[115] In addition to these Acts, the individual state-adopted securities laws, the "Blue Sky Laws," also define "security."[116]

Section 2(1) of the Securities Act defines the term "security" as follows:

> When used in this subchapter, unless the context otherwise requires . . . [t]he term "security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.[117]

Similar definitions of the term "security" can be found in section 3(a)(10) of the Securities Exchange Act,[118] section 2(16) of the Public Utility Holding Company Act,[119] section 2(a)(36) of the Investment Company Act,[120] and section 202(a)(18) of the Investment Advisers Act.[121]

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109. *See, e.g.*, James M. Landis, *Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959); MICHAEL E. PARRISH, SECURITIES REGULATION AND THE NEW DEAL 3-4 (1970).
110. 15 U.S.C. §§ 77a-77aa (2000).
111. *Id.* §§ 78a-78ll.
112. *Id.* §§ 79 to 79z-6.
113. *Id.* §§ 77aaa-77bbbb.
114. *Id.* §§ 80a-1 to 80a-64.
115. *Id.* §§ 80b-1 to 80b-21.
116. *See, e.g.*, Uniform Securities Act § 401(l) (amended 1958), 7C U.L.A. 190 (2000).
117. 15 U.S.C. § 77b(1).
118. *Id.* § 78c(a)(10).
119. *Id.* § 79b(a)(16).
120. *Id.* § 80a-2(a)(36).

The Trust Indenture Act does not provide a definition of "security," but it does refer directly to the definition of "security" given in the Securities Act.[122] Similar definitions can also be found in most State securities laws.[123]

The description given to the term "security" cannot be considered a true definition of the term "security" in the strict sense of the term. The term "security" is used as a generic term to encapsulate a broad range of instruments.[124] However, it does not lay down any economic criteria that these instruments must meet in order to be considered "securities." Furthermore, the phrase "unless the context otherwise requires" leads to the inevitable conclusion that even those instruments specifically included in the list of "securities" would not be considered "securities" in certain instances.[125] However, the statute gives no explanation as to what the phrase "unless the context otherwise requires" means.[126] Consequently, the definition given to the term "security" does not establish any criteria to distinguish securities from nonsecurities.[127] Nevertheless, the lack of any such criteria cannot be considered an oversight on the part of Congress, because it was never Congress's intention to incorporate economic criteria into the statutes at the time of the adoption of the Federal Securities Acts.[128] Some four decades later, the United States Supreme Court observed that, while including the definition of "securities" in the Securities Acts,

> Congress did not attempt to articulate the relevant economic criteria that would distinguish[] "securities" from "nonsecurities." . . . [The] task has fallen to the Securities and Exchange Commission (SEC), the body charged with administering the Securities Acts, and ultimately to the federal courts to decide which of the myriad financial transactions in our society fall within the coverage of these statutes.[129]

Of the numerous decisions handed down by the federal courts on this subject over the last seven decades, the most important are the eleven decisions handed down by the United States Supreme Court.[130] The

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121. *Id.* § 80b-2(a)(18).

122. *Id.* § 77ccc(1).

123. *See, e.g.*, Uniform Securities Act § 401(l) (amended 1958), 7C U.L.A. 190 (2000).

124. Black's Law Dictionary has a two-page definition of "security" that begins with "protection; assurance; indemnification." BLACK'S LAW DICTIONARY 1216 (7th ed. 1999).

125. 15 U.S.C. § 77b(a)(1).

126. *Id.*

127. *See id.*

128. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847 (1975).

129. *Id.* at 847-48.

130. Reves v. Ernst & Young, 494 U.S. 56 (1990); Gould v. Ruefenacht, 471 U.S. 701 (1985); Landreth Timber Co. v. Landreth, 471 U.S. 681 (1985); Marine Bank v. Weaver, 455 U.S.

highest court of the United States does not hand down decisions on purely theoretical questions outside the context of a specific legal dispute. However, in the process of determining whether an instrument is a "security," the Supreme Court not only has to determine the characteristics of a specific "security," but it also has to make a ruling on the broader question of what generally is understood by the term "security."[131] Therefore, if one could find a legal norm in each of the eleven decisions handed down by the United States Supreme Court on what the term "security" stands for, and systemized these norms, then it would be possible to provide a precise definition of what the term "security" means in U.S. law.

The first opportunity the Supreme Court had to interpret and apply the definition given to "security" in the Securities Act was the 1943 case, *SEC v. C.M. Joiner Leasing Corp.*[132] This case involved the sale of assignments of interests in Texas oil leases, subdivided by parcels.[133] The Supreme Court rejected a narrow interpretation of the term "security" and adopted a much broader interpretation of the term.[134] The Court held that "securities" include "[n]ovel, uncommon, or irregular devices . . . if it be proved as a matter of fact that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts,' or as 'any interest or instrument commonly known as a "security."'"[135]

In 1946, through the case *SEC v. W.J. Howey Co.*, the Supreme Court decided whether an offering of units in a citrus grove plantation together with a contract for cultivating, marketing, and remitting the net proceeds to the investor could be deemed a "security."[136] The Supreme Court interpreted and defined the term "investment contract" as a

> contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the

551 (1982); Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551 (1979); United Hous. Found., Inc. v. Forman, 421 U.S. 837 (1975); Tcherepnin v. Knight, 389 U.S. 332 (1967); SEC v. United Benefit Life Ins. Co., 387 U.S. 202 (1967); SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65 (1959); SEC v. W.J. Howey Co., 328 U.S. 293 (1946); SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344 (1943).

131. *See, e.g.*, *Howey*, 328 U.S. at 293.
132. *Joiner*, 320 U.S. at 344.
133. *Id.*
134. *Id.* at 351.
135. *Id.*
136. *Howey*, 328 U.S. at 295-97.

> enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.[137]

Following this decision, the Supreme Court devised the "*Howey* test" to determine the existence of an "investment contract."[138] The four criteria of the "*Howey* test" are whether the scheme involves: (1) an investment of money (2) in a common enterprise (3) with profits (4) to come solely from the efforts of others.[139]

In 1959, the Supreme Court held in *SEC v. Variable Annuity Life Insurance Co. of America* that variable annuity contracts, under which the issuer takes no risk and guarantees no minimum payment to the annuitant and the benefits vary completely according to the success or failure of the investment policy of the issuer, are not contracts of insurance.[140] Hence, issuers of such contracts not exempt from federal regulation under the "insurance" exemptions stated in the MacCarran-Fergusson Act,[141] the Securities Act, and the Investment Company Act, are subject to the registration requirements of the Securities Act.[142]

In *SEC v. United Benefit Life Insurance Co.*, in 1967, the Supreme Court held that in determining whether an annuity contract was subject to the registration requirements of the Securities Act, or was within the statute's insurance exemption, the operation of the contract during the deferred period while premiums were being paid was to be assessed independently from the post-maturity benefit scheme.[143] The Court also held that the accumulation provisions of the annuity contract constituted an "investment contract" under the Securities Act's definition of "security," and did not come within the insurance exemption because the issuer appealed to the purchaser on the prospect of growth through sound investment management.[144] The issuer's assumption of an investment risk through the guarantee of cash value based on net premiums "cannot by itself create an insurance provision under the federal definition."[145]

Later that year, the Supreme Court, in deciding the definition of "security" in *Tcherepnin v. Knight*, interpreted and applied the definition given to "security" in the Securities Exchange Act.[146] The Supreme Court

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137. *Id.* at 298-99.
138. *Id.*
139. *Id.* at 301.
140. SEC v. Variable Annuity Life Ins. Co. of Am., 359 U.S. 65, 67 (1959).
141. *Id.* at 80.
142. *Id.* at 71.
143. SEC v. United Benefit Life Ins. Co., 387 U.S. 202, 209 (1967).
144. *Id.* at 211.
145. *Id.* at 210-11.
146. Tcherepnin v. Knight, 389 U.S. 332, 346 (1967).

emphasised that the definitions given to "security" in the Securities Act and the Securities Exchange Act are virtually identical, so the coverage of the two Acts may be regarded as the same.[147] In rejecting a narrow or restrictive concept of "security," the Court held that withdrawable capital shares in the saving and loan association fit within several of the descriptive terms contained in section 3(a)(10) of the Securities Exchange Act, namely: "investment contracts," "certificate[s] of interest or participation in any profit-sharing agreement," "stock," and "transferable share[s]."[148]

In 1975, the Supreme Court held in *United Housing Foundation, Inc. v. Forman* that shares of stock issued by a housing cooperative, entitling the purchaser to lease an apartment owned and operated by the cooperative, were not "securities," since the shares did not possess the characteristics usually associated with common stock.[149] These characteristics are: (1) the right to receive dividends contingent upon the apportionment of profits, (2) negotiability, (3) the ability to be pledged or hypothecated, (4) the conferring of voting rights in proportion to the number of shares owned, and (5) the capacity to appreciate in value.[150] The incentive to purchase the shares was solely to acquire subsidized low-cost living space and not to invest for profit.[151]

In the 1979 case, *International Brotherhood of Teamsters v. Daniel*, the Supreme Court held that a noncontributory, compulsory pension plan does not constitute a "security" within the meaning of the Securities Acts, since an employee's participation in such a plan does not constitute an "investment contract."[152] The purported investment in such a plan is a relatively insignificant part of an employee's total and indivisible compensation package, and employer contributions to the plan are not equitable with an investment by the employee.[153] Despite the plan being dependent, to some extent, upon earnings from its asset funding benefits, the possibility of an employee participating in a plan's asset earnings is far too speculative and insubstantial to bring the entire transaction within the Securities Acts.[154] The Court also noted that the Employee Retirement Income Security Act of 1974 (ERISA), which comprehensively governed the "use and terms of employee pension plans

147. *Id.* at 335-36.
148. *Id.* at 338-39.
149. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975).
150. *Id.*
151. *Id.*
152. Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 570 (1979).
153. *Id.* at 560-61.
154. *Id.*

severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans," and "[w]hatever benefits employees might derive from the effect of the Securities Acts are now provided in more definitive form through ERISA."[155]

The Supreme Court held in the 1982 case, *Marine Bank v. Weaver*, that neither the certificate of deposit purchased from a federally regulated bank nor a unique profit-sharing agreement negotiated on a one to one basis by the parties was a "security."[156] While noting that the securities laws' antifraud provisions are not limited to instruments traded at securities exchanges and over-the-counter markets, but are extended to uncommon and irregular instruments, the Court indicated that "[t]he broad statutory definition [of 'security'] is preceded . . . by the statement that the terms mentioned are not to be considered securities if 'the context otherwise requires.'"[157] Consequently, it was "unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws."[158] At the same time, the Court indicated that it "does not follow that a certificate of deposit or a business agreement between transacting parties invariably falls outside the definition of a 'security' as defined by the federal statutes."[159] On the contrary, "each transaction should be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served and the factual settings as a whole."[160]

In 1985, three years after the *Weaver* decision, in *Landreth Timber Co. v. Landreth* and in *Gould v. Ruefenacht*, the Supreme Court held that the sale of 100 percent of outstanding stocks in a closed corporation involved the sale of a "security" within the meaning of the federal securities laws.[161] Although the instruments bear the label "stock," this, in itself, is not enough to invoke the Acts' coverage.[162] However, when an instrument is called "stock" and bears the usual characteristics of "stock," as identified in *Forman*, a purchaser justifiably may assume that

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155. *Id.* at 569-70.

156. Marine Bank v. Weaver, 455 U.S. 551, 559-60 (1982).

157. *Id.* at 556.

158. *Id.* at 559.

159. *Id.* at 560 n.11.

160. *Id.* This footnote to the decision could be considered as confirmation that "securities" can be recognized not only as financial instruments, which exist in documentary format, but also as transactions, which had already been highlighted by the *Howey* case.

161. Gould v. Ruefenacht, 471 U.S. 701, 705-06 (1985); Landreth Timber Co. v. Landreth, 471 U.S. 681, 696-97 (1985).

162. *Landreth*, 471 U.S. at 686.

the federal securities laws apply.[163] Moreover, when an instrument is labeled "stock" and possesses the traditional characteristics of stock, a court is not required to examine the economic substance of the transaction to determine whether the stock is a "security" within the meaning of the federal securities laws.[164] Therefore, "[i]nstruments that bear both the name and all of the usual characteristics of stock . . . [present] the clearest case for coverage by the plain language of the definition."[165]

Finally in *Reves v. Ernst & Young*, in 1990, the Supreme Court ruled that uncollateralised and uninsured promissory notes payable on demand by the holder fell within the "note" category of instruments that are "securities."[166] In order to determine whether an instrument, such as a "note," is a "security" under the definition given to "security" by the Securities Exchange Act, the Supreme Court applied the "family resemblance" test.[167] Under the test, a "note" is presumed to be a "security," and the presumption may be rebutted only by showing that the note bears a strong resemblance to certain instruments that are not securities.[168] Courts are to examine four specified factors: (1) the motivations of seller and buyer to enter into transaction, (2) the plan of distribution of the instrument, (3) the reasonable expectations of the investing public, and (4) the existence of some factor significantly reducing the risk of the instrument.[169] If an instrument is not sufficiently similar to a listed item, the court must decide whether another category should be added by examining the same factors.[170]

In analysing the eleven decisions handed down by the United States Supreme Court, one is able to define "security" as the transaction for placing money at the disposal of another person for the purpose of receiving profits, the document certifying this transaction, or the right to

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163. *Id.*

164. *Id.* at 691.

165. *Id.* at 693.

166. Reves v. Ernst & Young, 494 U.S. 56, 58-60 (1990). The notes were offered to both members and nonmembers of a farmer's cooperative and marketed as an "Investment Program" in order to raise money to support general business operations.

167. *Id.* at 66-67.

168. *Id.* at 65.

169. *Id.* at 66-67.

170. *Id.* at 67. Types of notes that are not "securities" include the note delivered in consumer financing; the note secured by a mortgage on a home; the short-term note secured by a lien on a small business or some of its assets; the note evidencing a "character" loan to a bank customer; short-term notes secured by an assignment of accounts receivable; or a note which simply formalizes an open-account debt incurred in the ordinary course of business (particularly if, as in the case of the customer of a broker, it is collaterized); or notes evidencing loans by commercial banks for current operations. *Id.* at 65.

its purchase or sale (hereinafter, collectively referred to as the "instrument").[171] A "security" is characterized by the following five circumstances: (1) the motivation of the seller to raise capital for the general use of a business enterprise or to finance substantial investments; (2) the motivation of the buyer to earn profit from its use; (3) "common trading for speculation or investment" in the instrument; (4) the reasonable expectations of the buyer that the instrument falls within the scope of the Securities Acts; and (5) the absence of a factor that would significantly reduce the risk of the instrument, rendering the application of the Securities Acts unnecessary.[172]

If the motivation of the seller is "to raise money for the general use of a business enterprise or to finance substantial investments" and the motivation of the buyer is primarily to earn profits from the investment, following *Reves v. Ernst & Young,* this instrument could be deemed a "security."[173] However, if the seller offers an instrument in order to "facilitate the purchase and sale of a minor asset or a consumer good, to correct for the seller's cash-flow difficulties, or to advance some other commercial or consumer purpose," then it is less likely that this instrument will be considered a "security."[174]

In order to establish whether there is "common trade for speculation or investment" in the instrument, there is no requirement to trade the instrument on the stock exchange or on the over-the-counter market.[175] The only requirement is that a number of potential buyers make offers to purchase.[176] With such offers, the fact that the final transaction would be between two parties only, or that the totality of the documents would be purchased by one buyer only, would not prevent the instrument from being classified as a "security."[177]

The buyer can reasonably expect that the Federal Securities Acts apply to the instrument if the name of the instrument and its characteristics so require.[178] This assumption can be made if the instrument is offered as an "investment" to a prospective buyer.[179] Following the decision handed down by the United States Supreme Court

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171. *Id.*
172. *Id.* at 66-67.
173. *Id.* at 66.
174. *Id.* The acquisition of an apartment for personal accommodation is an example of the consumer purpose that would prevent the consideration of the instrument as a "security." United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975).
175. Marine Bank v. Weaver, 455 U.S. 551, 556 (1982).
176. *Id.* at 559.
177. Landreth Timber Co. v. Landreth, 471 U.S. 681, 683 (1985).
178. *Id.* at 693.
179. Reves v. Ernst & Young, 494 U.S. 56 (1990).

in *Reves v. Ernst & Young*, where such public expectations exist, "instruments" shall be deemed "securities," "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."[180] The application of another regulatory scheme to the instrument could significantly reduce the risk of the "instrument," thereby rendering application of the Securities Acts unnecessary.[181] Examples that could be considered as such risk-reducing factors include federal banking regulations,[182] ERISA,[183] insurance,[184] or collateral.[185]

Regarding the types of "securities" that exist, an analysis of the terms used to define "securities" leads to the conclusion that this list is far from exhaustive.[186] In addition to the specific categories of instruments that denote "securities," the term "securities" also includes categories such as "investment contracts" and "certificates of interest or participation in a profit-sharing agreement," which are much broader in nature.[187] The inclusion of the latter enables novel, unusual, or irregular instruments to be classified as "securities," which, because of their name or their characteristics, would otherwise fall outside the traditional categories for "securities."[188] It would appear that this was the intention of Congress, which did not precisely define the scope of the Securities Acts, but rather "enacted a definition of 'security' sufficiently broad to encompass virtually any instrument that might be sold as an investment."[189]

IV. CONCEPTS OF "VALUABLE PAPER" AND "SECURITY": A COMPARATIVE ANALYSIS

There are few similarities between the concepts of "security" and "valuable paper." The main similarity is that these concepts are phenomena of the same kind, given that they fulfil a similar role in their respective legal systems. Legislators use the concepts of "security" and "valuable paper" in order to delineate the boundaries of government involvement in regulating capital markets. In providing definitions for

180. *Id.* at 66.
181. *Id.*
182. Marine Bank v. Weaver, 455 U.S. 551, 558 (1982).
183. Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 569-70 (1979).
184. Reves v. Ernst & Young, 494 U.S. 56, 69 (1990); *Marine Bank*, 455 U.S. at 558.
185. *Reves*, 494 U.S. at 69.
186. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 847-48 (1975).
187. *Reves*, 494 U.S. at 60; SEC v. W.J. Howey Co., 328 U.S. 293, 297 (1946).
188. *Reves*, 494 U.S. at 61; SEC v. C.M. Joiner Leasing Corp., 320 U.S. 344, 351 (1943).
189. *Reves*, 494 U.S. at 61.

these terms, legislators distinguish those instruments that fall within the scope of the legal provisions governing capital markets and investors in "securities" and "valuable papers" from those that fall outside the scope of these provisions.[190]

Moreover, from a historical perspective, there are similarities in how the concepts of "security" and "valuable paper" evolved within their respective legal systems. The concepts both emerged as a result of the identification of a common feature uniting a particular category of documents. However, the common feature uniting "securities" differs from the common feature uniting "valuable papers."

The term "security" derives its origins from the term "security for money," a term that U.S. law firmly established by the middle of the eighteenth century as a generic term for a broad range of debt documents.[191] The term "security for money" meant that while the debt document was not, strictly speaking, a security for payment, ownership of the document provided the creditor with a significant number of advantages thus securing the debt.[192] First, the very existence of the debt document confirmed the existence of the obligation and its terms, thereby reducing the risk of contention over the existence of the debt and the terms for repayment.[193] Second, if the debt document was negotiable in form, the debt became more liquid because it enabled the holder to immediately receive the debt amount by selling or by rediscounting the instrument.[194] However, by the middle of the nineteenth century, following the identification of the single feature, the debt document, the term "security for money" had been shortened to a single word "security."[195] On the other hand, Russian legal literature introduced the term "valuable paper" during the second half of the nineteenth century to denote documents that required presentation in order to execute the property rights which they certified.[196]

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190. 15 U.S.C. § 770(1) (defining "security" in U.S. law). For a definition of "valuable paper," see discussion *infra* Part II.

191. *See, e.g.*, Gary S. Rosin, *Historical Perspectives on the Definition of a Security*, 28 S. TEX. L. REV. 575, 600 (1987).

192. *Id.*

193. *Id.* at 600-01 (citing United States v. Isham, 84 U.S. 496 (1873)).

194. *Id.*

195. *See id.* at 602.

196. *See, e.g.*, 2 SHERSHENEVICH, *supra* note 22, at 63; A. Geine, *Bumagi na predyavitelya*, *in* 1 SLOVAR JURIDICHESKIH I GOSUDARSTVENNYKH NAUK [*The Bearer Papers*, *in* 1 THE DICTIONARY OF LEGAL AND STATE SCIENCES] 1291-92 (1901); N.O. NERSESOV, O BUMAGAKH NA PREDYAVITELYA S TOCHKI ZRENIA GRAZHDANSKOGO PRAVA [ON THE BEARER PAPERS FROM THE PERSPECTIVE OF CIVIL LAW] 5 (1998); I.K. GEILER, SBORNIK SVEDENII O PROTSENTNYKH BUMAGAKH ROSSII [A COMPENDIUM OF WORKS ON THE INTEREST-BEARING PAPERS OF RUSSIA], at xvi (1871).

Since the common feature which distinguished "valuable papers" from other documents was the presentation of the document, not the debt character of the obligation which it certified, stocks were included under the legal definition of "valuable paper" from the very outset.[197] However, unlike Russian legislation,[198] U.S. legislation initially excluded stocks from the scope of the term "security" because stocks were not considered "securities for money."[199] A "share certificate," unlike a "security for money," was not considered a promise or an order to pay money, but "physical evidence of the shareholder's share of the capital stock. . . . [The] ownership of the share did not entitle the holder to a sum [of money]."[200] It only represented a contingent interest in the corporation's assets.[201] Nevertheless, courts began to apply the term "security" to a much broader range of documents that fall within the scope of the term "investment" and evidence transactions where one invests money with the expectation of earning profits, including shares and share certificates.[202] Common usage in state case law reflected this change[203] and later through the state securities laws (the "Blue Sky Laws").[204]

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197. Geine, *supra* note 196.

198. It should be noted, however, that there was no consensus in continental legal theory on the classification of "stocks" as "valuable papers." In discussing the matter of bearer valuable papers, a distinguished German scholar, Friedrich Karl von Savigny, included shares as "valuable papers," however, not without serious reservations: "[W]e are dealing with obligations and bearers, who are creditors; stocks are the documents evidencing participation in property to the railway or any other industrial enterprise; the owner of stocks is a participant in a joint ownership." F.K. SAVIGNY, OBYAZATELSTVENNOE PRAVO [THE LAW OF OBLIGATIONS] 433 (Fuks & Mandro trans., 1876). Indeed, of all the valuable papers, stock occupies a distinct place. Unlike other valuable papers, the possibility of exercising the rights certified by stocks (the right to receive dividends, the right to the share of the capital of the company) is based not on a single legal fact (the purchase of a "valuable paper"), but on a combination of legal facts (the purchase of stock and the decision to apportion profits or the purchase of stock and the decision to liquidate the company). If the profits are not apportioned or the company is not liquidated, the owner of the stock does not have the right to claim dividends or part of the assets of the company. In other words, while the rights of holders of valuable papers other than stock are "unconditional" and could be exercised within a time prescribed by the paper itself, the rights of shareholders are "conditional" and appear only after these conditions are satisfied.

199. Rosin, *supra* note 191, at 603.

200. *Id.*

201. *Id.*

202. *Id.*

203. *See, e.g.*, *In re* Stark's Will, 134 N.W. 389, 399 (Wis. 1912).

204. For example, section 6(a) of the Corporate Securities Act, adopted in California in 1917, provided that the word "security" includes all shares or other interests or rights into which the capital, capital stock, or property of companies or rights of stockholders or members thereof are divided, including all treasury shares and shares of their own capital stock purchased or otherwise acquired by companies upon delinquent assessment sales or in any other lawful manner, and all certificates and other instruments issued by them or their authority, evidencing or representing such shares, interests, or rights. 1917 CAL. STAT. 532 § 6(a). Similarly, the law of Wisconsin, adopted in 1919, provided that "security" or "securities" means and includes any

The fundamental difference between the concepts of "security" and "valuable paper" lies in the different ideas placed at the core of these concepts. In the case of "security," the core idea is the "investment" character of the instrument,[205] whereas in the case of the "valuable paper," the fundamental idea is the existence of an inseparable link between the document and the right certified by the document.[206] While a "security" is recognized as the transaction for placing money at the disposal of another person for the purpose of earning profits and as the document certifying this transaction, as well as the right to purchase or sell this document, a "valuable paper" only is recognized as the document certifying the transaction.[207]

The investment character of a "security" is its "internal" characteristic, and the requirement to present the document for the exercise or the transfer of the right certified by a "valuable paper" is its "external" characteristic, as set out by law.[208] This distinction illustrates the different approaches of American and Russian legislators in the classification of documents that are deemed "securities" or "valuable papers." Article 143 of GK RF refers only to standardized instruments that demonstrate the need to define clearly the documents required to be presented in order to exercise or transfer the rights certified by the documents.[209] Unlike instruments that are deemed "securities," those which are deemed "valuable papers" in article 143 of GK RF are not preceded by the phrase "unless the context otherwise requires."[210] Finally, while the definition of "security" allows for the classification of "any interest or instrument commonly known as a 'security,'"[211] article 143 of GK RF does not provide for the similar classification of "valuable papers."[212] However, it was Congress's intention, in adopting a sufficiently broad definition of "security," to include virtually every instrument that might be sold as an investment.[213] This can be seen in the standardized instruments (e.g., "stock" or "bond") and the broader categories of instruments (e.g., "investment contract" or "certificate of

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bonds, stocks, notes or other obligations or evidence of indebtedness or of title which constitutes evidence of, or is secured by, title to, interest in or lien upon any or all of the property or profits of such company. 1919 WIS. LAWS 674, § 1(c).

205. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293 (1946).
206. GK RF art. 142(1).
207. *Id.*
208. *Id.*
209. *Id.* art. 143.
210. *Id.*
211. 15 U.S.C. § 77b(1) (2000).
212. GK RF art. 143.
213. Marine Bank v. Weaver, 455 U.S. 511, 559 (1982); 15 U.S.C. § 77b(1).

interest or participation in any profit-sharing agreement") that are listed as "securities."[214]

As we have seen, while the concept of "security" places the emphasis on the internal substance of the financial instrument (its investment character), the concept of "valuable paper" emphasises its external form (the existence of the required documentary format and requisites). This difference can be seen in the different procedures for the classification of "securities" and "valuable papers" as financial instruments in U.S. and Russian legislation and in the differing roles that U.S. and Russian courts play in resolving disputes.

In order to classify a document as a "valuable paper," it must possess the statutory requisites and mandatory format.[215] If the document does not possess the proper requisites or is not in the mandatory format, then it cannot be classified as a "valuable paper."[216] However, since neither article 144 of GK RF, nor Chapter 7 of GK RF in general, contains the phrase "unless the context requires otherwise," the document will be considered a "valuable paper" in all cases where it meets the statutory requisites and format. When classifying a document as a "valuable paper" where the name of the document differs from any of the existing types of "valuable papers," it will be subject to the document if it satisfactorily meets two conditions. First, the document must possess, with the exception of its name, all the requisites of one of traditional "valuable paper." Second, the name of the document must not be included in the mandatory requisites for this type of "valuable papers."[217] Under GK RF article 144, section 2, when the name of a "valuable paper" is one of its mandatory requisites, the absence of any reference to its name in the body of the document precludes the document from being classified as a "valuable paper," regardless of whether all the remaining mandatory requisites for this type of "valuable paper" have been met.[218]

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214. Reves v. Ernst & Young, 494 U.S. 56, 61 (1990); SEC v. W.J. Howey, 328 U.S. 293, 297 (1946).

215. GK RF art. 144(2).

216. *Id.*

217. For example, the name is not included in the mandatory requisites for the double warehouse receipt and each of its two parts and the ordinary warehouse receipt. GK RF arts. 913, 917.

218. GK RF art. 144(2). For example, the names "bill of exchange" and "promissory note" are included in the list of the mandatory requisites of bills of exchange and notes. *See* articles 1(1) and 75(1) of the Regulations No. 104/1341 of 7 August 1937, "On bills of exchange and promissory notes," Sobr. zakonov y rasporyazhenii raboche-krestyanskogo pravitelstva U.S.S.R., 1937, No. 52, Item 221 (Russ.), applied on the territory of the Russian Federation in accordance with Federal Law No. 48-FZ of 11 March 1997 "On promissory notes and bills of exchange," Sobr. Zakonod. RF, 1997, No. 11, Item 1238 (Russ.).

The procedure for classifying a financial instrument listed in the statutory definition among the types of "securities" as a "security" is dependent upon the name of the instrument. For example, if the instrument bears the name "stock," in determining whether such "stock" may be considered a "security," one needs to establish whether it possesses the five characteristics usually associated with common stock as identified in *United Housing Foundation, Inc. v. Forman*,[219] and *Landreth Timber Co. v. Landreth*.[220] Similarly, if the instrument bears the name "note," it should be analysed from the perspective of the "family resemblance test."[221] Because the United States Supreme Court has not yet established any special test or criteria for determining whether other standardized instruments may be classified as "securities," these instruments need to be analysed from the perspective of the four factors of the "family resemblance" test in order to establish whether they are "securities."[222] If the instrument bears a name which is not listed as a type of "security" under the statutory definition for "security," it may still be classified as a "security" provided that it is included in one of the broader categories (e.g., an investment contract).[223] However, if the name of the instrument corresponds to one explicitly referred to in the statutory definition, it may still be classified as a "nonsecurity" if the court decides that it falls within the category "unless the context otherwise requires."[224]

The courts' role in resolving disputes that arise out of the classification of financial instruments as "valuable papers" in the Russian Federation, is limited to determining whether a document possesses the statutory requisites and format for the type of "valuable paper" in question. However, in the United States the courts have a much broader role, since U.S. courts are able to exercise their legislative function and determine for themselves the criteria for distinguishing "securities" from "nonsecurities."[225]

There are far more similarities than differences between "securities" and "emissive valuable papers." First, both "emissive valuable papers" and "securities" need not be documents.[226] Second, the name of the

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219. 421 U.S. 837, 851 (1975).
220. 471 U.S. 681, 686 (1985).
221. Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).
222. *Id.*
223. *Id.* at 67.
224. Marine Bank v. Weaver, 455 U.S. 551, 558-59 (1982).
225. With respect to the legislative function of the U.S. courts, see, for example, BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 124-25 (1991).
226. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 18, pt. 7 (Russ.); 15 U.S.C. § 77(b).

instrument is not the deciding factor in determining whether a combination of property and nonproperty rights may be deemed an "emissive valuable paper."[227] Third, "emissive valuable papers" and "securities" have common legal characteristics: (1) the general prohibition on placing "emissive valuable papers" and "securities" that have not been registered with the appropriate government body;[228] (2) the requirement to disclose information concerning placed "emissive valuable papers" and "securities";[229] and (3) the restriction on using insider information for trading in "emissive valuable papers" or "securities."[230] Consequently, it is the term "emissive valuable paper," not the term "valuable paper," that should be considered the closest analogy in the Russian legal system to the U.S. term "security."[231]

V. TYPES OF "VALUABLE PAPERS" AND "SECURITIES": A COMPARATIVE ANALYSIS

In carrying out a comparative analysis of the various types of "valuable papers" and "securities" in circulation, the similarities and the differences that exist between these two concepts become evident. On the one hand, when we consider that "presentability" is not an essential characteristic of the term "security," we are able to conclude that not one document deemed a "security" in U.S. legislation would be considered a "valuable paper" in Russian legislation. On the other hand, the following "valuable papers" would be considered "securities" in U.S. law: stocks, certain types of bonds issued by legal entities, certain types of government and municipal bonds, certain types of "other government (municipal) valuable papers," certain types of notes, and option certificates for those valuable papers, which are considered "securities."[232]

The Valuable Papers Market Law defines "stock" as an "emissive valuable paper," certifying the right of its holder (the shareholder) to

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227. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 18, pt. 7 (Russ.); 15 U.S.C. § 77(b).

228. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 18, pt. 7 (Russ.); 15 U.S.C. § 77(e).

229. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 30 (Russ.); article 6 of Federal Law No. 46-FZ of 5 March 1999 "On protecting the interests of investors in the valuable papers market," Sobr. Zakonod. RF, 1999, No. 10, Item 1163 (Russ.); 15 U.S.C. § 77(g).

230. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 33 (Russ.); 15 U.S.C. § 78(j) (Rule 10(b-5) in security litigation).

231. Valuable Papers Market Law, Sobr. Zakond. RF, 1996, No. 17, Item 1918, art. 33 (Russ.); 15 U.S.C. § 78(j).

232. *See* discussion *infra* Part IV.

receive a part of the profits of the joint-stock company in the form of dividends, to participate in the management of the joint-stock company, and to receive a part of the assets remaining following liquidation.[233] Stocks issued under Russian legislation fall within the scope of the term "security," because they possess all of the five characteristics usually associated with common stock, as identified in *United Housing Foundation, Inc. v. Forman*, and *Landreth Timber Co. v. Landreth*.[234] First, both the Law on joint-stock companies and the Valuable Papers Market Law entitles shareholders to receive dividends conditional upon the apportionment of profits.[235] The negotiability of stocks follows from GK RF article 142, section 1(2), which refers to the "transfer of valuable papers" and provides for the negotiation of stocks.[236] GK RF article 454, section 2, also recognizes the negotiability of stocks, stating that the general provisions governing purchase-sale agreements shall apply to the purchase-sale of "valuable papers," unless the context otherwise requires.[237] GK RF article 336, section 1, provides for any property, including things[238] and, by extension, "valuable papers" and stocks to be pledged.[239] The law on joint stock companies and the Valuable Papers Market Law explicitly provide for the conferring of voting rights in accordance with the number of shares owned.[240] Finally, the Legislature's recognition that stocks may appreciate in value follows from article 36 of the Law on joint-stock companies, which provides for the payment of stocks according to their market value and not a value lower than their nominal value.[241]

GK RF defines a "bond" as a "valuable paper" that entitles the holder to receive from the issuer of the bond the nominal value of the

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233. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 2, pt. 2 (Russ.).

234. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975); Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 (1985).

235. Article 31 of Federal Law No. 208-FZ of 26 December 1995 "On Joint-stock companies" (as amended), Sobr. Zakonod. RF, 1996, No. 1, Item 1; 1996, No. 25, Item 2956 (Russ.) [hereinafter Law on Joint-stock companies]; Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 2, pt. 2 (Russ.).

236. GK RF art. 142(1)(2).

237. *Id.* art. 454(2).

238. GK RF article 128 stipulates that the term "things" includes valuable papers. GK RF art. 128.

239. GK RF arts. 336(1), 128, 130(2). The term "hypothecated" is used in Russian law in reference to immovable property. However, under section 2 of article 130 of GK RF, "valuable papers" in the Russian Federation (including stock) are deemed "movable property." *Id.* art. 130(2).

240. Law on Joint-stock companies, *supra* note 235, art. 31, § 2; Valuable Papers Market Law, Sobr. Zakond. RF, 1996, No. 17, Item 1918, art. 2, pt. 2 (Russ.).

241. Law on Joint-stock companies, *supra* note 235, art. 36.

bond or equivalent property in the period envisaged by the bond.[242] A bond also entitles the holder to "receive a percentage of the bond's nominal value [or] any other property rights."[243] Like American notes, Russian Federation bonds may be used in both an investment and commercial context. That is why, in light of the United States Supreme Court decision handed down in *Reves v. Ernst & Young*, a bond issued in the Russian Federation would be presumed to be a "security" until such time as an examination of the bond from the perspective of the four factors of the "family resemblance test" rebuts this presumption.[244] Under the first factor, the motivation of the seller and the buyer to enter into a transaction, a bond issued in the Russian Federation to facilitate the purchase and the sale of a minor asset, reverse cash flow difficulties, or advance a commercial purpose would not be considered a "security."[245] Bonds issued in the Russian Federation by banks would also not be considered "securities," because the existence of other regulatory schemes significantly reduce the risk of the instrument[246] and renders the application of the Federal Securities Acts unnecessary.[247] On the other hand, for the classification of bonds as "valuable papers" under Russian Federation legislation, it is irrelevant whether the bond is being issued for commercial or investment purposes or whether the issuer is a bank or another personality (nonbank).

Government bonds are bonds issued in the name of the Russian Federation, or in the name of a constituent territory of the Russian Federation (known literally as a "subject of the Russian Federation"), whereas municipal bonds are bonds issued in the name of a municipal authority.[248] Only those varieties of Russian government and municipal bonds which authorise the holder to receive the nominal value of the bond may be deemed "securities."[249] This conclusion may be drawn from

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242. GK RF art. 816.

243. *Id.*

244. Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).

245. *Cf. id.* at 66.

246. The activities of banks in general and the emissive of bonds by banks in the Russian Federation, in particular, are governed by special legislation—the legislation on banks. *See, e.g.*, Law of 2 December 1990 "On banks and banking activity," Sobr. Zakonod. RF, 1996, No. 6, Item 492, 1998, No. 31, Item 3829 (Russ.); Instruction No. 8 of 17 September 1996 of the Central Bank of the Russian Federation, "On the rules of issuing and registering valuable papers by commercial banks in the Russian Federation" (as amended), Vest. Banka Rossii, 1996, No. 46, 1996, No. 64 (Russ.).

247. *Reves*, 494 U.S. at 67; *see also* Wolf v. Banco Nacional de Mexico, S.A., 739 F.2d 1458, 1463 (9th Cir. 1984).

248. Law on the peculiarities of valuable papers, Sobr. Zakonod. RF, 1998, No. 31, Item 3814, art. 2, § 1 (Russ.).

249. *Id.*; Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1999).

the application of the "family resemblance" test to Russian government and municipal bonds.[250] First, when we examine the motivation of the seller and the buyer to enter into a transaction, the Budget Code of the Russian Federation lists the issuance of government and municipal bonds as a means of financing shortfalls in the various budgets.[251] The seller's motivation, in this instance, is to raise monetary resources for general use. However, a buyer of a government bond, which stipulates the repayment of the bond's nominal value, purchases the bond not from a commercial or consumer perspective. He purchases in order to receive a financial return on the investment made, either in interest payments, if the bond so provides, or in the difference between the purchase price and the nominal price of the bond, if the bond does not envisage interest payments but is sold with a discounted nominal value. Second, when we examine the distribution plan of the instrument, since government and municipal bonds are usually offered and sold to the wider public and are freely traded, including on the stock exchange, we can see that there is "common trading for speculation or investment" in this instrument. In examining the government bond against the third factor, the reasonable expectations of the investing public, one can see that government and municipal bonds issued in the Russian Federation meet this criteria and, consequently, may be considered "securities." Finally, regarding the fourth factor, there is no risk-reducing factor, such as the existence of another regulatory scheme or insurance that would significantly reduce the risk of government and municipal bonds, thereby precluding government and municipal bonds from being classified as "securities."[252]

On the other hand, the Russian government or municipal bonds that do not allow the buyer to receive the bond's nominal value, only property in kind (e.g., as in the case of a "golden certificate") are not considered "securities" under the "family resemblance" test.[253] Even though these

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250. *Reves*, 494 U.S. at 66.

251. Articles 95-95 of the Budget Code of the Russian Federation, Sobr Zakonod. RF, 1998, No. 31, Item 3823 (Russ.); *see also* Federal Law No. 159-FZ of 9 July 1999 "On implementing the Budget Code of the Russian Federation," Sobr. Zakonod. RF, 1999, No. 28, Item 3492 (Russ.).

252. The absence of the risk-reducing factor applicable to Russian government bonds was clearly displayed during the financial crisis in August 1998, when the government defaulted on government short-term bonds (GKO) and the debt merely was restructured. *See, e.g.*, Resolution No. 1007 of 25 August 1998 of the Government of the Russian Federation, "On the redemption of government short-term non-coupon bonds and federal loan bonds with permanent and variable coupon incomes issued into circulation prior to 17 August 1998 and with a redemption date of 31 December 1999 and issued into circulation before 17 August 1998," Sobr. Zakonod. RF, 1998, No. 35, Item 4409 (Russ.).

253. A golden certificate is an inscribed "valuable paper" bearing no interest, which grants the holder the right to receive, at the time of its redemption, as provided for in the conditions of

bonds meet the second and fourth factors of the test, namely the existence of "common trading for speculation or investment" and the absence of any risk-reducing factor, they do not meet the first and third factors of the test. Therefore, they cannot be deemed "securities." Since the purchase-sale of these bonds evidences the purchase-sale of a physical commodity for a deferred delivery,[254] from the perspective of the first factor of the test, the issuance of government and municipal valuable papers could be deemed to be promoting a commercial purpose. In the eyes of the United States Supreme Court, this type of activity renders the description of this type of note as a "security" to be "less sensible."[255] Moreover, any profit emanating from the purchase of this type of bond is not generated by the bond itself (as in bonds which provide for their redemption in monetary form), but by the resale of the bond to a third person or the subsequent resale of the physical commodity to a third person, after the due date for the redemption of the bond. Finally, from the perspective of the reasonable expectations of the investing public, the third factor of the test, the issuance of government or municipal valuable papers as a means to facilitate the sale of a physical commodity makes it impossible to consider these instruments as "securities."[256]

The same results even where these "valuable papers" are not named "bonds," but instead are considered as contracts for the purchase-sale of the commodity in question. In applying the *Howey* test to such a contract, we are able to conclude that contracts of this type cannot be considered as "securities," because they are not "investment contracts."[257] First, while there is an "investment of money" (the payment of the purchase price for the "valuable paper" in question), there is no "common enterprise" element.[258] Moreover, the buyer's profits are not

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issuance, gold bullion equivalent to 1 kilogram of chemically pure gold for every redeemed golden certificate. *See, e.g.*, sections 1 and 2 of the "General Conditions of the issuance and the circulation of government bonds, redeemed by gold," approved by Government Resolution No. 861 of 27 June 1998 "On the General Conditions of issuance and circulation of government bonds, redeemed by gold." Sobr. Zakonod. RF, 1998, No. 32, Item 3897 (Russ.).

254. For example, the sale of golden certificates represents the sale of gold in bullions, the delivery of which could be demanded at the time of the redemption of the certificate.

255. *Cf.* Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990). According to the United States Supreme Court, if the instrument denominated as "note" is exchanged to advance a commercial purpose, this instrument is less sensibly described as a "security." *Id.*

256. *Reves*, 494 U.S. at 66.

257. *See* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

258. As concerns golden certificates, section 3 of Article 21 of the Federal Law No. 41-FZ of 26 March 1998 "On the precious metals and precious stones" indicates that the government valuable papers, denominated in precious metals, could be issued for the purposes of encouraging *investments* into the development of extraction and production of precious stones (emphasis added). Sobr. Zakonod., 1998, No. 13, Item 1463 (Russ.). However, the money received from the

"solely from the efforts of the promoter or a third party" but from market price fluctuations in the commodity in question.[259] Therefore, contracts of this nature cannot be deemed "securities."[260]

With respect to "other government and municipal valuable papers," neither the GK RF nor the Law on the peculiarities of the issuance and the circulation of government and municipal "valuable papers" lays down any additional types of government or municipal "valuable papers." The Law on the peculiarities of the issuance and the circulation of government and municipal "valuable papers" merely provides that the latter may be issued in the form of bonds or other "valuable papers" belonging to "emissive valuable papers."[261] This is to be done in accordance with the Valuable Papers Market Law, which entitles the holder to receive money from the issuer or, subject to the terms of issuance, other property, a fixed percentage of the nominal value, or other property rights within the period laid down in the conditions of issuance.[262]

The application of the "family resemblance" test to the possible types of "other government or municipal valuable papers" leads to the conclusion that only those "valuable papers" that entitle the buyer to receive from the issuer the amount paid for the "valuable paper" or a fixed interest rate may be deemed "securities." However, under the "family resemblance" test, "other government or municipal valuable papers" which entitle the holder to receive only physical property, or other such property rights, cannot be deemed "securities."[263]

Current legislation in the Russian Federation envisages two types of *notes*: a promissory note and a bill of exchange.[264] GK RF defines a promissory note as a "valuable paper" that unconditionally obliges the drawer of the promissory note to pay the drawee, at a specified time in the future, a specific sum of money, namely the amount borrowed.[265] A

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sale of golden certificates is not transferred directly to a specific enterprise or mine, but goes to the government budget in a "depersonalized" form.

259. *Howey*, 328 U.S. at 299.

260. *Cf.* SEC v. Belmont Reid Co., 794 F.2d 1388, 1391 (9th Cir. 1986); Alan R. Bromberg, *Commodities Law and Securities Law—Overlaps and Preemptions*, 2 J. CORP. L. 217, 221-22 (1976); George K. Chamberlin, J.D., Annotation, *Commodity Futures Contract or Account as Included in Meaning of "Security" as Defined in § 3(a)(10) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(10))*, 58 A.L.R. FED. 616, 622 (1982).

261. Law on the peculiarities of the issuance and the circulation of government and municipal valuable papers, Sobr. Zakonod. RF, 1998, No. 31, Item 3814, art. 3 (Russ.).

262. *Id.*

263. Law on promissory notes and bills of exchange, Sobr. Zakonod. RF, 1997, No. 11, Item 1238, art. 1 (Russ.).

264. *Id.*

265. GK RF art. 807(1).

bill of exchange, on the other hand, is a "valuable paper" that enforces a similar obligation on another payer named in the bill of exchange.[266] The drawer of a bill of exchange payable on demand or payable after a certain time following the demand may envisage an accumulation of interest on the amount of the bill.[267] In any other bill of exchange this condition shall not be considered stipulated.[268] The bill of exchange shall indicate the interest rate, and, if it does not, the condition shall not be considered stipulated.[269] Interest shall accrue from the day the bill of exchange is drawn, and, where no such indication is made, the condition shall not be considered stipulated.[270] The same rules apply to promissory notes.[271]

Of the notes issued in the Russian Federation following the *Reves v. Ernst & Young* decision, only those promissory notes and bills of exchange that envisage the accumulation of interest and that are offered and sold to a broad segment of the public for the purpose of raising money for the general use of a business enterprise or financing substantial investments may be deemed "securities."[272] On the other hand, when we consider the abstract nature of the obligations of the owner arising out of a note issued under Russian Federal legislation, for the determination whether a certain note could be considered as a "valuable paper," the purpose of the issuance of this note is irrelevant.[273]

An investment share is an "inscribed valuable paper" entitling the investor, upon the presentation of a demand, to redeem the share for money calculated on the basis of the value of the investment fund's assets at the time of redemption.[274] The interest and dividends under investment shares are neither accumulated nor paid.[275] Investment shares would be included within the scope of the term "security" because they satisfy the

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266. *Id.* art. 815.
267. *Id.* art. 813.
268. Article 5 of the Regulations on notes and bills of exchange.
269. *Id.*
270. *Id.*
271. *Id.* art. 77.
272. Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).
273. The abstract character of the obligation arising out of the note means that the obligation under the note is totally unconditional and does not depend on the cause of its issuance (the underlying transaction). For example, a buyer in a purchase-sale agreement can issue a bill of exchange instead of transferring money to the seller's account. The buyer will have to pay against the presentation of this bill of exchange, even if the agreement itself may have been subsequently declared void. *Cf.* L.A. Novoselova, *Nedeystvitelnost sdelki, lezhashey v osnove vydachi vekselya, ne vlechet nedeystvitelnosti vekselya* [*The nonvalidity of the transaction, which gave rise to the issuance of the note, does not result in the nonvalidity of the note itself*], Vestn. Vyssh. Arb. Suda RF, 1998, No. 6, P. 101-07; 2 GRAZHDANSKOYE PRAVO [CIVIL LAW], *supra* note 16, at 477.
274. Section 29 of Standard Rules of share investment fund.
275. *Id.*

four elements of the *Howey* test and, consequently, may be deemed "investment contracts."[276] There is an investment of money (the purchase of the investment share) in a common enterprise (the investment fund) with profits (the difference between the purchase price and the redemption price) to come solely from the efforts of others (the success of the investment strategy of the investment fund, reflected in the increase in value of the fund's assets).[277]

An option certificate is an "inscribed valuable paper" that entitles the holder, at a particular date and subject to the conditions laid down in the certificate, to buy (option certificate to buy) or sell (option certificate to sell) the "valuable papers" (base asset) of the issuer of the option certificate or of the third party.[278] Since the phrase "any put, call, straddle, option, or privilege on any security" is explicitly included in the definition of "security," those option certificates that certify the rights to buy or to sell "valuable papers," would therefore be included within the scope of the U.S. term "security" and could be considered such.[279]

On the other hand, the following types of "valuable papers" would not be included within the scope of the term "security": cheques, deposit certificates, savings certificates, bearers bank saving passbooks, bills of lading, privatization valuable papers, double warehouse receipts, each of the two parts of a double warehouse receipt (i.e., the warehouse receipt and the mortgage certificate (warrant)), ordinary warehouse receipts, mortgage certificates, housing certificates, and government housing certificates.[280]

A *cheque* is a "valuable paper" that imposes an unconditional order on the bank of the drawer to make a payment of the amount specified in the cheque to its holder.[281] The drawer may indicate only that bank where the drawer has the monetary resources that he may legally dispose of through the drawing up of a cheque.[282]

A *bill of lading* is a "valuable paper" issued by a maritime carrier to the shipper of the cargo, and entitles the shipper to give orders with respect to the cargo indicated in the bill of lading and to receive it after

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276. SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

277. *Id.*

278. Section 1 of Resolution No. 1 of 9 January 1997, of the Federal Commission for the valuable papers market "On the option certificate, its use and the approval of Standards of issuance of option certificates and the prospectus of their issuance." Bulletin of the Federal Commission for the valuable papers market, 1997, No. 1(6), p. 1-25 (Russ.).

279. 15 U.S.C. § 77b(a)(1).

280. *Id.*

281. GK RF art. 877(1).

282. *Id.* art. 877(2).

completion of the transportation.[283] The bill of lading may be made to the order of a named consignee (inscribed bill of lading), to the order of the shipper or the consignee (order bill of lading) or to the holder.[284] An order bill of lading, which provides no indication as to whether it was issued by the shipper or the consignee, shall be considered as issued to the order of the shipper of the cargo.[285]

Double warehouse receipts and *ordinary warehouse receipts* are "valuable papers" issued by warehouses as confirmation of receipt of goods for storage.[286] The double warehouse receipt is made up of two parts—a warehouse receipt and a mortgage certificate (warrant), each of which may be treated as a separate document.[287] Each part of a double warehouse receipt is a "valuable paper."[288]

A *mortgage certificate* is an "inscribed valuable paper" that entitles its legitimate holder to receive performance under the monetary obligation secured by the mortgage of the property and specified in the mortgage agreement.[289] This entitlement can occur without presentation of any other proof of existence of this obligation, and the right of the mortgagee to the property specified in the mortgage agreement.[290]

Cheques, bills of lading, double warehouse receipts, each of the two parts of a double warehouse receipt, ordinary warehouse receipts, and mortgage certificates do not fall within the scope of the term "security," because they do not fit into any of the specific categories listed in the legal definition of "security."[291] In addition, following the decision handed down by the United States Supreme Court in *United Housing Foundation, Inc. v. Forman*, the purchasers of these "valuable papers" do not receive profits in either of the two forms that would satisfy the third element of the *Howey* test.[292] Consequently, these types of "valuable papers" do not fit into either of the categories "investment contract" or

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283. *See* articles 142-149 of the Merchant Shipping Code of the Russian Federation. Sobr. Zakonod. RF, 1999, No. 18, Item 2207 (Russ.) [hereinafter KTM RF].

284. *Id.*

285. KTM RF art. 146.

286. GK RF art. 912(1).

287. *Id.* art. 912(2).

288. *Id.* art. 912(3).

289. Federal Law No. 196-F2 of 16 July 1998 "On hypothèque" (mortgage of immovables). Sobr. Zakonod. RF, 1998, No. 31, Item 3400, art. 13, pt. 2 (Russ.).

290. *Id.*

291. GK RF art. 143; 15 U.S.C. § 77b(a)(1) (2000).

292. "By profits, the Court has meant either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investor's funds." United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975); *see also* SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

"certificate of interest or participation in any profit-sharing agreement."[293]

A *savings certificate (deposit certificate)* is a "valuable paper" that certifies the amount of deposit made to a bank, and entitles the depositor (the holder of the certificate) to receive from the bank or from any branch of the bank, following the expiry of a specified term, the amount of the deposit and the interest envisaged in the certificate issued by the bank.[294] Savings certificates (deposit certificates) can be inscribed or issued to the bearer.[295] *Bearers bank savings passbooks*, on the other hand, are "valuable papers" that certify the conclusion of a bank deposit agreement with a private individual and the placing of money through a deposit into this account.[296]

Following the decision handed down by the United States Supreme Court in *Marine Bank v. Weaver*, savings certificates, deposit certificates and bearers' bank savings passbooks would not fall within the scope of the term "security."[297] In the Russian Federation, banks only issue these types of "valuable papers."[298] Since the activities of banks, in general, and the issuance of these types of "valuable papers," in particular, in the Russian Federation are comprehensively regulated by banking legislation,[299] it would be unnecessary also to place them under the application of the Securities Acts.[300]

There is no definition currently for *"privatization valuable papers"* in Russian legislation. The closet corollary, privatization cheques, known as "vouchers," introduced in the Russian Federation as a privatization tool at the beginning of the 1990s, following the decision handed down by the United States Supreme Court in *SEC v. W.J. Howey, Co.*, would not fall within the scope of the term "security."[301] In the Russian Federation privatization cheques are used to purchase the objects of

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293. *United Hous. Found., Inc.*, 401 U.S. at 852; *Howey*, 328 U.S. at 301.

294. GK RF art. 844(1).

295. *Id.* art. 844(2).

296. *Id.* art. 843(1).

297. *See* Marine Bank v. Weaver, 455 U.S. 551 (1982).

298. GK RF arts. 843-844.

299. Letter No. 14-3-20 of 10 February 1992 of the Central Bank of the Russian Federation "On deposit certificates and savings certificates issued by banks" (as amended), Normativnye acty po bankovskoy deyatelnosty, 1994, No. 4-5, p. 43-49 (Russ.) (governing the issuance and circulation of certificates of deposit and savings certificates in the Russian Federation).

300. *Cf. Marine Bank*, 455 U.S. at 558-59.

301. Regulations governing privatization cheques, approved by Presidential Decree No. 914 of 14 August 1992 "On implementing the system of privatization cheques in the Russian Federation." Vedomosti syezda narodnykh deputatov RF y verkhovnogo soveta RF, 1992, No. 35, Item 2001 (Russ.); SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946).

privatization, as well as stocks (shares) of specialized investment funds that accumulate privatization cheques under the Regulations approved by the Russian Federation Government Property Management Committee (*Goskomimushestvo*).[302] In order to receive a privatization cheque the law requires Russian citizens to pay a fee.[303] While the payment of this fee can be considered an "investment of money" (thereby satisfying the first element of the *Howey* test), the "common enterprise" element of the test appears to be missing.[304] Because privatization cheques are used as a means of payment for the subsequent purchase of investments (such as stocks (shares) of investment funds), their acquisition is merely an intermediary step and could not in itself be considered an investment in the "common enterprise."[305]

A *housing certificate* is a special type of bond, providing for the indexation of the bond's nominal value, entitling the holder of the certificate: (1) to acquire an apartment (apartments), on the condition that a block of housing certificates are purchased, under the procedure and conditions laid down in the Regulations on the issuance and the circulation of housing certificates, and the respective conditions governing their issuance, or (2) to receive from the issuer the indexed nominal value of the housing certificate on first demand.[306] The indexation scheme with respect to the nominal value of the housing certificate shall be prescribed at the time of issuance and shall remain unchanged during the prescribed period governing the validity of the housing certificate.[307] Housing certificates do not grant voting rights at the issuer's shareholders' meetings or the right to profit share or share of the total amount of assets of the issuer of the housing certificate.[308]

If we apply the "family resemblance" test to housing certificates, one finds that they are classed as those debt instruments that are not deemed "securities."[309] Therefore, they fall outside the scope of the term

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302. This name has bee subsequently changed to "Ministry of Government Property of the Russian Federation" (*Mingosimushestvo Rossii*). *See* Presidential Decree No. 1063 of 30 September 1997 "On the Ministry of Government Property of the Russian Federation." Sobr. Zakonod. RF 1998, No. 40, Item 4583 (Russ.).

303. Part 2 of section 2 of Presidential Decree No. 914 of 14 August 1992.

304. *Howey*, 328 U.S. at 301.

305. *Id.*

306. Part 1 of section 2 of the Regulation governing the issuance and the circulation of housing certificates.

307. Part 2 of section 2 of the Regulation governing the issuance and the circulation of housing certificates.

308. Section 1(a) of Instructions on the procedure for the issuance, circulation and redemption of housing certificates in the Russian Federation, approved by Resolution No. 2 of 12 May 1995 of the Federal Commission for the valuable papers market.

309. Reves v. Ernst & Young, 494 U.S. 56, 66-67 (1990).

"security."[310] In determining whether a housing certificate could be considered a "security" under the first factor of the test, the motivation of the seller and the buyer to enter into a transaction, one needs to make a comparison of the indexation rate of the housing certificate's nominal value against the interest rate paid by local banks, or savings and credit companies, for each certificate issued.[311] If the indexation rate is higher than the interest rate, it is reasonable to assume that the buyer has acquired the certificate in order to invest for profit. The United States Supreme Court decision in *Reves v. Ernst & Young* confirms the presumption that the housing certificate is a "security."[312] However, if the indexation rate of the housing certificate's nominal value is equal to or less than the interest rate paid by local banks or savings and credit companies, this circumstance would seem to indicate that the buyer's intention, in purchasing the certificate, is to acquire accommodation, i.e., as evidence of the existence of the consumer purpose. This circumstance, following *Reves v. Ernst & Young*, would rebut the presumption that, in this instance, the housing certificate could be considered a "security."[313]

Given that the holder of the housing certificates has the right to freely sell these certificates for their market value, one can conclude that there is "common trading for speculation or investment" in these certificates.[314] Therefore, insofar as the second factor of the "family resemblance" test is concerned, housing certificates could be considered "securities."[315]

The reasonable expectations of the investing public (the third factor of the test) may be determined, in each specific issue of housing certificates, by the promotion of these certificates in advertisements.[316] If the advertisements promote these housing certificates as a means of earning financial returns, i.e., as "investments," this could support the finding that they are "securities."[317] However, if they are promoted as a means of acquiring accommodation at an attractive price, this could

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310. *Id.*
311. *Id.*
312. *Id.*
313. *Id.* at 67.
314. Section 17 of the Regulations on the issuance and the circulation of housing certificates; section 19 of the Instructions on the procedure for the issuance, circulation and redemption of housing certificates.
315. *Reves*, 494 U.S. at 66.
316. *Id.*
317. *Id.*

refute the presumption that housing certificates could be considered "securities."[318]

Regardless of whether we can consider housing certificates to be "securities" under the first three factors of the "family resemblance" test, the fourth factor of the test, the existence of a risk-reducing factor, would rebut the presumption that housing certificates could be considered "securities."[319] Under the regulations on the issuance and the circulation of housing certificates, the issuer of a housing certificate must enter into a contract with a guarantor (e.g., a bank or an insurance company).[320] Under such a contract, in the event of the nonperformance of the obligation by the issuer of the certificate, the guarantor undertakes to pay the owner of the certificate the nominal value of the certificate, calculated in accordance with its indexation scheme.[321] Therefore, the rights afforded the owner of the housing certificate under such a contract could be considered a factor that significantly reduces the risk associated with the housing certificate.[322] This is because the existence of a contract virtually eliminates the risk of nonrepayment of the nominal value of the certificate.[323] As a result, under *Reves v. Ernst & Young*, the existence of this factor precludes the certificate from being considered a "security."[324]

Finally, a *government housing certificate* is an inscribed nontransferable "valuable paper" given to Russian citizens who have lost their housing as a result of an emergency situation or a natural disaster so that they may receive housing.[325] Government housing certificates cannot be considered "securities" under the "family resemblance" test.[326] First, government housing certificates are issued solely for the purpose of acquiring housing, i.e., for the consumer purpose, and not for the purpose of earning profits.[327] Where the motivation of the purchaser of

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318. *Cf.* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 851 (1975).

319. *Reves*, 494 U.S. at 66.

320. Section 12 of the Regulations on the issuance and the circulation of housing certificates; the section of Instructions on the procedure for the issuance, circulation and redemption of housing certificates.

321. Part 2 of section 9 of the Regulations on the issuance and the circulation of housing certificates; part 2 of section 5.1 and section 23 of the Instructions on the procedure for the issuance, circulation and redemption of housing certificates.

322. *Reves*, 494 U.S. at 67.

323. *Id.*

324. *Id.*

325. Section 1 of Resolution No. 561 of 7 June 1995 of the Government of the Russian Federation; section 2 of the Procedure for the issuance and the redemption of government housing certificates.

326. *See id.*; *Reves*, 494 U.S. at 66-67.

327. Section 1 of Resolution No. 561 of 7 June 1995 of the Government of the Russian Federation.

such an instrument is to acquire housing (i.e., the first factor of the "family resemblance test") this type of instrument would be less sensibly described as a "security."[328] Furthermore, government housing certificates are nontransferable "valuable papers" and, as such, are not subject to alienation in any form.[329] Since there is no right of transfer and, consequently, no "common trading for speculation or investment," the second factor of the "family resemblance test" precludes government housing certificates from being considered "securities."[330] Finally, government housing certificates are not sold to their recipients, but the government gives them gratuitously to individuals who satisfy the established criteria of need.[331] Therefore, in so far as government housing certificates are concerned, there is no "investment of money," and consequently, no reasonable expectation of the investing public, as is required of "securities" under the third factor of the "family resemblance test."[332]

The results of the above comparative analysis of the various types of "securities" and "valuable papers" clearly show that the term "valuable paper," or the need to present a document for the exercise or the transfer of the right certified by this document, embraces a wide variety of instruments of diverse economic substance.[333] That is why only those Russian "valuable papers" that have an "investment character" would fall within the scope of the term "security." On the other hand, the term "security" covers only those instruments that are "investments," i.e., those instruments that are similar in economic substance.[334] Regarding instruments that are similar to Russian "valuable papers" and not deemed "securities" under U.S. legislation, these fall within a separate concept, the concept of negotiable instruments[335] or of documents of title.[336]

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328. *Reves*, 494 U.S. at 66.

329. Section 2 of the Procedure for the issuance and the redemption of government housing certificates.

330. *Reves*, 494 U.S. at 66.

331. Section 2 of Resolution No. 561 of 7 June 1995 of the Government of the Russian Federation.

332. *Reves*, 494 U.S. at 66.

333. This fact is reflected in the subdivision of "valuable papers" in Russian legal theory into three categories: (1) monetary valuable papers (e.g., notes), (2) commercial valuable papers (e.g., bills of lading or warehouse receipts); and (3) investment valuable papers (e.g., stocks or bonds). *See, e.g.*, 1 GRAZHDANSKOYE PRAVO [CIVIL LAW] (Sukhanov)], *supra* note 67, at 319-20.

334. 15 U.S.C. § 77(b)(1) (2000).

335. U.C.C. § 3-104 (1999).

336. *Id.* § 7-104.

VI. CONCLUSION

The comparative analysis of the concepts of "security" and "valuable paper" and the various types of "securities" and "valuable papers" suggests that, from the point of view of the effective regulation of capital markets as well as that of protecting investors, the American concept of "security" has considerable advantages over that of the Russian concept of "valuable paper." The similarity in the economic substance of the instruments covered within the scope of the term "security" provides for a uniform and comprehensive legal regulatory system to be established. However, the wide range of instruments that fall within the scope of the term "valuable paper" severely restricts the number of legal provisions that could be universally applied to these instruments, thereby making this concept of little practical value to the regulation of Russian capital markets. The imposition of a general prohibition on the placing of "emissive valuable papers" that have not been registered with the appropriate government body[337] as well as on the disclosure of information on "emissive valuable papers"[338] that have been placed, is fully justified for "valuable papers" such as shares, bonds, or state bonds, which are offered to a broad segment of the public. However, the same requirement cannot be justified for bills of lading, promissory notes or bills of exchange, which are negotiated on a one-to-one basis by the transacting parties. Invalidating an "emissive valuable paper" where the mandatory requisites are absent or the "valuable paper" is issued in a nonprescribed format[339] in order to protect investors cannot be justified since this would exclude purchasers of nontraditional financial instruments and individuals who are the victims of fraudulent investment schemes in the Russian Federation from the protective provisions of the Valuable Papers Market Law.[340] Finally, the possibility of introducing new types of "valuable papers" from January 1, 1995, through the "laws on valuable papers" has created a real challenge for potential investors in Russian valuable papers not mentioned by name in GK RF. Prior to purchasing a "valuable paper," a buyer must establish whether the legislation governing the classification of the instrument as a

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337. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 18, pt. 7 (Russ.).

338. *Id.* art. 30.

339. GK RF art. 144(2).

340. For example, the application of the provisions of Chapter 8 of the Valuable Papers Market Law prohibiting the use of insider information for trading in emissive valuable papers, and the provisions of Chapter 9 of the legislation governing the content of advertisements in capital markets and establishing the liability for damages caused by unscrupulous advertisements.

"valuable paper" is a "law on valuable papers." Should buyers choose not to do so, then they run the risk of facing a subsequent challenge regarding the legality of the instruments.

The concept of "emissive valuable papers," however, does not have these shortcomings. In fact, it has considerable advantages in that it covers both the document and the combination of property and nonproperty rights certified by the document, regardless of the name they are given.[341] Consequently, the concept of "emissive valuable papers" is flexible enough to protect purchasers of nontraditional financial instruments against fraudulent activities.[342] Despite these advantages, this provision has been severely criticised in Russian legal literature for flying in the face of traditional concepts, because it places rights and documents ("valuable papers") on an equal footing.[343] In fact, the Valuable Papers Market Law article 16, part 13, and the concept of "emissive valuable papers" as a whole would appear not to conform with the current concept of "valuable papers" as provided for in GK RF.[344]

There are at least two possible ways of eliminating this contradiction. The first of which is to recognize that, following the enactment of the Valuable Papers Market Law in 1996, the scope of the term "valuable paper" has expanded considerably and now includes rights as well as traditional documents. These changes need to be incorporated into the legal definition given to the term "valuable paper" in GK RF.[345] However, in light of U.S. experience acquired through the enactment of the definition of "security" and its subsequent judicial interpretation, adopting such an approach to resolve this problem would be wholly inappropriate.[346] In reality, this new concept covers not only a variety of different documents with totally different economic significance, but also different rights. This would further reduce the possibility of establishing a uniform system to legally regulate these documents and rights.

Another way in which to eliminate the contradiction between the concepts of "emissive valuable papers" and "valuable papers" is to refuse

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341. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 16, pt. 13 (Russ.).

342. *See id.*

343. For example, Professor Sukhanov considers the equation of rights and valuable papers as a "misunderstanding." GRAZHDANSKOYE PRAVO [CIVIL LAW] (Sukhanov)], *supra* note 67, at 322.

344. Valuable Papers Market Law, Sobr. Zakonod. RF, 1996, No. 17, Item 1918, art. 16, pt. 13 (Russ.).

345. GK RF art. 142(1).

346. *See generally* 15 U.S.C. § 77(b)(1) (2000).

to consider "emissive valuable papers" as a form of "valuable paper." This proposal would lead to neither the need to reconsider what is understood by the term "valuable paper" nor to its discontinuation.[347] We need only recognize that the introduction of the term "emissive valuable paper" into Russian legislation, in 1996, has made it necessary to reconsider the role and the significance of the term "valuable paper" in Russian legislation.

Following the introduction of the term "emissive valuable paper" in Russian legislation, the term "valuable paper" should be used only for "documentary valuable papers," which are not "investments" and not placed in issues. In regard to stocks, bonds, and other "valuable papers," which are "investments" by nature and are capable of being placed in issues, these should be regulated within the framework of an independent concept. Consequently, a number of financial instruments, such as stocks and bonds, which are traditionally considered "valuable papers" under Russian law and in Russian legal theory, would no longer fall within the scope of the term "valuable paper" when issued as "emissive valuable papers." From a practical stance, this solution would allow us to establish a range of legal regulations to govern those instruments that are considered "investments" and whose purchasers are entitled to additional protection by the government, and those instruments that are not considered "investments" and whose purchasers require no such additional protection.

Regarding the suggestion that "emissive valuable papers" should no longer be deemed "valuable papers," the question arises regarding continued use of the term "emissive valuable paper." Further use of this term could be justified only on the grounds of its symbolic character, in much the same way that the term "nondocumentary valuable paper" is used. However, a clear disadvantage to this approach is that, while the rules established for "valuable papers" apply also to "nondocumentary valuable papers," it is anticipated that the name "emissive valuable paper" will be used to distinguish legislation regulating "emissive valuable paper" from legislation that regulates "valuable papers." This, again, may lead to certain difficulties, particularly for foreign investors who are unfamiliar with the details of Russian law. Consequently, it may be more reasonable, at some future point, to replace the term "emissive

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347. With respect to the existence of "nondocumentary valuable papers," it should be noted that a number of Russian scholars adopted this position as early as the beginning of the 1990s. *See, e.g.*, A.A. Kozlov, *K voprosu o termine "tsennye bumagi"* [*Questions on the term "valuable papers"*], Dengi i Credit, 1991, No. 9, pp. 55-56 (Russ.).

valuable papers" in Russian legislation with the term "investments" or the term "capital values."[348]

348. There are already certain examples. In the Financial Services Act, adopted in 1996, the term "investments" establishes the boundaries for the government regulation of the U.K. capital markets. *See, e.g.*, S. Miller, *Regulating Financial Services in the United Kingdom—An American Perspective*, 44 BUS. LAW. 323, 333 (1989).