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CHAPTER 8.

INVESTMENT SECURITIES

Drafting Approach‑‑Neutrality Principle

One of the objectives of the revision of Article 8 is to devise a structure of commercial law rules for investment securities that will be sufficiently flexible to respond to changes in practice over the next few decades. If it were possible to predict with confidence how the securities holding and trading system would develop, one could produce a statute designed specifically for the system envisioned. Recent experience, however, shows the danger of that approach. The 1978 amendments to Article 8 were based on the assumption that the solution to the problems that plagued the paper‑based securities trading system of the 1960s would be the development of uncertificated securities. Instead, the solution thus far has been the development of the indirect holding system.

If one thought that the indirect holding system would come to dominate securities holding, one might draft Article 8 rules designed primarily for the indirect holding system, giving limited attention to the traditional direct holding system of security certificates or any uncertificated version of a direct holding system that might develop in the future. It is, however, by no means clear whether the long‑term evolution will be toward decreased or increased use of direct holdings. At present, investors in most equity securities can either hold their securities through brokers or request that certificates be issued in their own name. For the immediate future it seems likely that that situation will continue. One can imagine many plausible scenarios for future evolution. Direct holding might become less and less common as investors become more familiar and comfortable with book‑entry systems and/or as market or regulatory pressures develop that discourage direct holding. One might note, for example, that major brokerage firms are beginning to impose fees for having certificates issued and that some observers have suggested that acceleration of the cycle for settlement of securities trades might be facilitated by discouraging customers from obtaining certificates. On the other hand, other observers feel that it is important for investors to retain the option of holding securities in certificated form, or at least in some form that gives them a direct relationship with the issuer and does not require them to hold through brokers or other securities intermediaries. Some groups within the securities industry are beginning to work on development of uncertificated systems that would preserve this option.

Revised Article 8 takes a neutral position on the evolution of securities holding practices. The revision was based on the assumption that the path of development will be determined by market and regulatory forces and that the Article 8 rules should not seek to influence that development in any specific direction. Although various drafting approaches were considered, it became apparent early in the revision process that the differences between the direct holding system and the indirect holding system are sufficiently significant that it is best to treat them as separate systems requiring different legal concepts. Accordingly, while the rules of the prior version of Article 8 have, in large measure, been retained for the direct holding system, a new Part 5 has been added, setting out the commercial law rules for the indirect securities holding system. The principle of neutrality does carry some implications for the design of specific Article 8 rules. At the very least, the Article 8 rules for all securities holding systems should be sufficiently clear and predictable that uncertainty about the governing law does not itself operate as a constraint on market developments. In addition, an effort has been made to identify and eliminate any Article 8 rules that might act as impediments to any of the foreseeable paths of development.

B. Direct Holding System

With respect to securities held directly, Revised Article 8 retains the basic conceptual structure and rules of present law. Part 2, which is largely unchanged from former law, deals with certain aspects of the obligations of issuers. The primary purpose of the rules of Part 2 is to apply to investment securities the principles of negotiable instruments law that preclude the issuers of negotiable instruments from asserting defenses against subsequent purchasers. Part 3 deals with transfer for securities held directly. One of its principal purposes is to apply to investment securities the principles of negotiable instruments law that protect purchasers of negotiable instruments against adverse claims. Part 4 deals with the process of registration of transfer by the issuer or transfer agent.

Although the basic concepts of the direct holding system rules have been retained, there are significant changes in terminology, organization, and statement of the rules. Some of the major changes are as follows:

Simplification of Part 3. The addition of the new Part 5 on the indirect holding system makes unnecessary the rather elaborate provisions of former law, such as those in Section 8‑313, that sought to fit the indirect holding system into the conceptual structure of the direct holding system. Thus, Part 3 of Revised Article 8 is, in many respects, more similar to the original version of Article 8 than to the 1978 version.

Protected purchaser. The prior version of Article 8 used the term "bona fide purchaser" to refer to those purchasers who took free from adverse claims, and it used the phrase "good faith" in stating the requirements for such status. In order to promote clarity, Revised Article 8 states the rules that protect purchasers against adverse claims without using the phrase "good faith" and uses the new term "protected purchaser" to refer to purchasers in the direct holding system who are protected against adverse claims. See Sections 8‑105 and 8‑303.

Certificated versus uncertificated securities. The rules of the 1978 version of Article 8 concerning uncertificated securities have been simplified considerably. The 1978 version added provisions on uncertificated securities parallel to the provisions of the original version of Article 8 dealing with securities represented by certificates. Thus, virtually every section had one set of rules on "certificated securities" and another on "uncertificated securities." The constant juxtaposition of "certificated securities" and "uncertificated securities" has probably led readers to overemphasize the differences. Revised Article 8 has a unitary definition of "security" in Section 8‑102(a)(15) which refers to the underlying intangible interest or obligation. In Revised Article 8, the difference between certificated and uncertificated is treated not as an inherent attribute of the security but as a difference in the means by which ownership is evidenced. The terms "certificated" and "uncertificated" security are used in those sections where it is important to distinguish between these two means of evidencing ownership. Revised Article 8 also deletes the provisions of the 1978 version concerning "transaction statements" and "registered pledges." These changes are explained in the Revision Notes 3, 4, and 5, below.

Scope of Parts 2, 3, and 4. The rules of Parts 2, 3, and 4 deal only with the rights of persons who hold securities directly. In typical securities holding arrangements in the modern depository system, only the clearing corporation would be a direct holder of the securities. Thus, while the rules of Parts 2, 3, and 4 would apply to the relationship between the issuer and the clearing corporation, they have no application to relationships below the clearing corporation level. Under Revised Article 8, a person who holds a security through a broker or securities custodian has a security entitlement governed by the Part 5 rules but is not the direct holder of the security. Thus, the rules of Revised Section 8‑303 on the rights of "protected purchasers," which are the analog of the bona fide purchaser rules of former Article 8, do not apply to persons who hold securities through brokers or securities custodians. Instead, Part 5 contains its own rules to protect investors in the indirect holding system against adverse claims. See Revised Section 8‑502.

C. Indirect Holding System

Although the Revised Article 8 provisions for the indirect holding system are somewhat complex, the basic approach taken can be summarized rather briefly. Revised Article 8 abandons the attempt to describe all of the complex relationships in the indirect holding system using the simple concepts of the traditional direct holding system. Instead, new rules specifically designed for the indirect holding system are added as Part 5 of Article 8. In a nutshell, the approach is to describe the core of the package of rights of a person who holds a security through a securities intermediary and then give that package of rights a name.

The starting point of Revised Article 8's treatment of the indirect holding system is the concept of "security entitlement." The term is defined in Section 8‑102(a)(17) as "the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5." Like many legal concepts, however, the meaning of "security entitlement" is to be found less in any specific definition than in the matrix of rules that use the term. In a sense, then, the entirety of Part 5 is the definition of "security entitlement" because the Part 5 rules specify the rights and property interest that comprise a security entitlement.

Part 5 begins by specifying, in Section 8‑501, when an entitlement holder acquires a security entitlement. The basic rule is very simple. A person acquires a security entitlement when the securities intermediary credits the financial asset to the person's account. The remaining sections of Part 5 specify the content of the security entitlement concept. Section 8‑504 provides that a securities intermediary must maintain a sufficient quantity of financial assets to satisfy the claims of all of its entitlement holders. Section 8‑503 provides that these financial assets are held by the intermediary for the entitlement holders, are not the property of the securities intermediary, and are not subject to claims of the intermediary's general creditors. Thus, a security entitlement is itself a form of property interest not merely an in personam claim against the intermediary. The concept of a security entitlement does, however, include a package of in personam rights against the intermediary. Other Part 5 rules identify the core of this package of rights, subject to specification by agreement and regulatory law. See Sections 8‑505 through 8‑509.

To illustrate the basic features of the new rules, consider a simple example of two investors, John and Mary, each of whom owns 1000 shares of Acme, Inc., a publicly traded company. John has a certificate representing his 1000 shares and is registered on the books maintained by Acme's transfer agent as the holder of record of those 1000 shares. Accordingly, he has a direct claim against the issuer, he receives dividends and distributions directly from the issuer, and he receives proxies directly from the issuer for purposes of voting his shares. Mary has chosen to hold her securities through her broker. She does not have a certificate and is not registered on Acme's stock books as a holder of record. She enjoys the economic and corporate benefits of ownership but does so through her broker and any other intermediaries in the chain back to the issuer. John's interest in Acme common stock would be described under Revised Article 8 as a direct interest in a "security." Thus, if John grants a security interest in his investment position, the collateral would be described as a "security." Mary's interest in Acme common stock would be described under Revised Article 8 as a "security entitlement." Thus, if Mary grants a security interest in her investment position, the collateral would be described as a "security entitlement."

For many purposes, there is no need to differentiate among the various ways that an investor might hold securities. For example, for purposes of financial accounting, John and Mary would each be described as the owner of 1000 shares of Acme common stock. For those purposes it is irrelevant that John is the registered owner and has physical possession of a certificate, while Mary holds her position through an intermediary. Revised Article 8 recognizes this point in Section 8‑104 which provides that acquiring a security entitlement and acquiring a security certificate are different ways of acquiring an interest in the underlying security.

D. Security Interests

Along with the revision of Article 8, significant changes have been made in the rules concerning security interests in securities. The revision returns to the pre‑1978 structure in which the rules on security interests in investment securities are set out in Article 9, rather than in Article 8. The changes in Article 9 are, in part, conforming changes to adapt Article 9 to the new concept of a security entitlement. The Article 9 changes, however, go beyond that to establish a simplified structure for the creation and perfection of security interests in investment securities, whether held directly or indirectly.

The Revised Article 9 rules continue the long‑established principle that a security interest in a security represented by a certificate can be perfected by a possessory pledge. The revised rules, however, do not require that all security interests in investment securities be implemented by procedures based on the conceptual structure of the common law pledge. Under the revised Article 9 rules, a security interest in securities can be created pursuant to Section 9‑203 in the same fashion as a security interest in any other form of property, that is, by agreement between the debtor and secured party. There is no requirement of a "transfer," "delivery," or any similar action, physical or metaphysical, for the creation of an effective security interest. A security interest in securities is, of course, a form of property interest, but the only requirements for creation of this form of property interest are those set out in Section 9‑203.

The perfection methods for security interests in investment securities are set out in Sections 9‑309, 9‑312, 9‑313, and 9‑314. The basic rule is that a security interest may be perfected by "control." The concept of control, defined in Section 8‑106, plays an important role in both Article 8 and Article 9. In general, obtaining control means taking the steps necessary to place the lender in a position where it can have the collateral sold off without the further cooperation of the debtor. Thus, for certificated securities, a lender obtains control by taking possession of the certificate with any necessary indorsement. For securities held through a securities intermediary, the lender can obtain control in two ways. First, the lender obtains control if it becomes the entitlement holder; that is, has the securities positions transferred to an account in its own name. Second, the lender obtains control if the securities intermediary agrees to act on instructions from the secured party to dispose of the positions, even though the debtor remains the entitlement holder. Such an arrangement suffices to give the lender control even though the debtor retains the right to trade and exercise other ordinary rights of an entitlement holder.

Except where the debtor is itself a securities firm, filing of an ordinary Article 9 financing statement is also a permissible alternative method of perfection. However, filing with respect to investment property does not assure the lender the same protections as for other forms of collateral, since the priority rules provide that a secured party who obtains control has priority over a secured party who does not obtain control.

The details of the new rules on security interests, as applied both to the retail level and to arrangements for secured financing of securities dealers, are explained in the Official Comments to Sections 9‑309, 9‑312, 9‑313, and 9‑314.

III. SCOPE AND APPLICATION OF ARTICLE 8

A.

Terminology

To understand the scope and application of the rules of Revised Article 8, and the related security interest rules of Article 9, it is necessary to understand some of the key defined terms:

Security, defined in Section 8‑102(a)(15), has essentially the same meaning as under the prior version of Article 8. The difference in Revised Article 8 is that the definition of security does not determine the coverage of all of Article 8. Although the direct holding system rules in Parts 2, 3, and 4 apply only to securities, the indirect holding system rules of Part 5 apply to the broader category of "financial assets."

Financial asset, defined in Section 8‑103(a)(9), is the term used to describe the forms of property to which the indirect holding system rules of Part 5 apply. The term includes not only "securities," but also other interests, obligations, or property that are held through securities accounts. The best illustration of the broader scope of the term financial asset is the treatment of money market instruments, discussed below.

Security entitlement, defined in Section 8‑103(a)(17), is the term used to describe the property interest of a person who holds a security or other financial asset through a securities intermediary.

Securities intermediary, defined in Section 8‑103(a)(14), is the term used for those who hold securities for others in the indirect holding system. It covers clearing corporations, banks acting as securities custodians, and brokers holding securities for their customers.

Entitlement holder, defined in Section 8‑103(a)(7), is the term used for those who hold securities through intermediaries.

Securities account, defined in Section 8‑501(a), describes the form of arrangement between a securities intermediary and an entitlement holder that gives rise to a security entitlement. As explained below, the definition of securities account plays a key role in setting the scope of the indirect holding system rules of Part 5.

Investment property, defined in Section 9‑102(a)(49), determines the application of the new Article 9 rules for secured transactions. In addition to securities and security entitlements, the Article 9 term "investment property" is defined to include "securities account" in order to simplify the drafting of the Article 9 rules that permit debtors to grant security interests either in specific security entitlements or in an entire securities account. The other difference between the coverage of the Article 8 and Article 9 terms is that commodity futures contracts are excluded from Article 8, but are included within the Article 9 definition of "investment property." Thus, the new Article 9 rules apply to security interests in commodity futures positions as well as security interests in securities positions.

B. Notes on Scope of Article 8

Article 8 is in no sense a comprehensive codification of the law governing securities or transactions in securities. Although Article 8 deals with some aspects of the rights of securities holders against issuers, most of that relationship is governed not by Article 8, but by corporation, securities, and contract law. Although Article 8 deals with some aspects of the rights and duties of parties who transfer securities, it is not a codification of the law of contracts for the purchase or sale of securities. (The prior version of Article 8 did include a few miscellaneous rules on contracts for the sale of securities, but these have not been included in Revised Article 8). Although the new indirect holding system rules of Part 5 deal with some aspects of the relationship between brokers or other securities professionals and their customers, Article 8 is still not in any sense a comprehensive code of the law governing the relationship between broker‑dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law.

The distinction between the aspects of the broker‑customer relationship that are and are not dealt with in this Article may be illuminated by considering the differing roles of the broker in a typical securities transaction, in which the broker acts as agent for the customer. When a customer directs a broker to buy or sell securities for the customer, and the broker executes that trade on a securities exchange or in the over the counter market, the broker is entering into a contract for the purchase or sale of the securities as agent of the customer. The rules of the exchange, practices of the market, or regulatory law will specify when and how that contract is to be performed. For example, today the terms of the standard contract for trades in most corporate securities require the seller to deliver the securities, and the buyer to pay for them, five business days after the date that the contract was made, although the SEC has recently promulgated a rule that will accelerate the cycle to require settlement in three business days. In the common speech of the industry, the transaction in which the broker enters into a contract for the purchase or sale of the securities is referred to as executing the trade, and the transaction in which the securities are delivered and paid for is referred to as settlement. Thus, the current settlement cycle is known as T+" 5, that is, settlement is required on the fifth business day after the date of the trade, and the new SEC rule will change it to T+" 3. One must be careful in moving from the jargon of the securities industry to the jargon of the legal profession. For most practical economic purposes, the trade date is the date that counts, because that is the time at which the price is set, the risk of price changes shifts, and the parties become bound to perform. For purposes of precise legal analysis, however, the securities phrase "trade" or "execute a trade" means enter into a contract for the purchase or sale of the securities. The transfer of property interests occurs not at the time the contract is made but at the time it is performed, that is, at settlement.

The distinction between trade and settlement is important in understanding the scope of Article 8. Article 8 deals with the settlement phase of securities transactions. It deals with the mechanisms by which interests in securities are transferred, and the rights and duties of those who are involved in the transfer process. It does not deal with the process of entering into contracts for the transfer of securities or regulate the rights and duties of those involved in the contracting process. To use securities parlance, Article 8 deals not with the trade, but with settlement of the trade. Indeed, Article 8 does not even deal with all aspects of settlement. In a netted clearance and settlement system such as the NSCC‑DTC system, individual trades are not settled one‑by‑one by corresponding entries on the books of any depository. Rather, settlement of the individual trades occurs through the clearing arrangements, in accordance with the rules and agreements that govern those arrangements.

In the rules dealing with the indirect holding system, one must be particularly careful to bear in mind the distinction between trade and settlement. Under Revised Article 8, the property interest of a person who holds securities through an intermediary is described as a "security entitlement," which is defined in Revised Section 8‑102(a)(17) as the package of rights and property interest of an entitlement holder specified in Part 5. Saying that the security entitlement is a package of rights against the broker does not mean that all of the customer's rights against the broker are part of the security entitlement and hence part of the subject matter of Article 8. The distinction between trade and settlement remains fundamental. The rules of this Article on the indirect holding system deal with brokers and other intermediaries as media through which investors hold their financial assets. Brokers are also media through which investors buy and sell their financial assets, but that aspect of their role is not the subject of this Article.

The principal goal of the Article 8 revision project is to provide a satisfactory framework for analysis of the indirect holding system. The technique used in Revised Article 8 is to acknowledge explicitly that the relationship between a securities intermediary and its entitlement holders is sui generis, and to state the applicable commercial law rules directly, rather than by inference from a categorization of the relationship based on legal concepts of a different era. One of the consequences of this drafting technique is that in order to provide content to the concept of security entitlement it becomes necessary to identify the core of the package of rights that make up a security entitlement. Sections 8‑504 through 8‑508 cover such basic matters as the duty of the securities intermediary to maintain a sufficient quantity of securities to satisfy all of its entitlement holders, the duty of the securities intermediary to pass through to entitlement holder the economic and corporate law rights of ownership of the security, and the duty of the securities intermediary to comply with authorized entitlement orders originated by the entitlement holder. These sections are best thought of as definitional; that is, a relationship which does not include these rights is not the kind of relationship that Revised Article 8 deals with. Because these sections take the form of statements of the duties of an intermediary toward its entitlement holders, one must be careful to avoid a distorted perspective on what Revised Article 8 is and is not designed to do. Revised Article 8 is not, and should not be, a comprehensive body of private law governing the relationship between brokers and their customers, nor a body of regulatory law to police against improper conduct by brokers or other intermediaries. Many, if not most, aspects of the relationship between brokers and customers are governed by the common law of contract and agency, supplemented or supplanted by federal and state regulatory law. Revised Article 8 does not take the place of this body of private and regulatory law. If there are gaps in the regulatory law, they should be dealt with as such; Article 8 is not the place to address them. Article 8 deals with how interests in securities are evidenced and how they are transferred. By way of a rough analogy, one might think of Article 8 as playing the role for the securities markets that real estate recording acts play for the real estate markets. Real estate recording acts do not regulate the conduct of parties to real estate transactions; Article 8 does not regulate the conduct of parties to securities transactions.

C. Application of Revised Articles 8 and 9 to Common Investments and Investment Arrangements

It may aid understanding to sketch briefly the treatment under Revised Articles 8 and 9 of a variety of relatively common products and arrangements.

1. Publicly traded stocks and bonds.

"Security" is defined in Revised Section 8‑102(a)(15) in substantially the same terms as in the prior version of Article 8. It covers the ordinary publicly traded investment securities, such as corporate stocks and bonds. Parts 2, 3, and 4 govern the interests of persons who hold securities directly, and Part 5 governs the interest of those who hold securities indirectly.

Ordinary publicly traded securities provide a good illustration of the relationship between the direct and indirect holding system rules. The distinction between the direct and indirect holding systems is not an attribute of the securities themselves but of the way in which a particular person holds the securities. Thus, whether one looks to the direct holding system rules of Parts 2, 3, and 4 or the indirect holding system rules of Part 5 will depend on the level in the securities holding system being analyzed.

Consider, for example, corporate stock which is held through a depository, such as DTC. The clearing corporation, or its nominee, is the registered owner of all of the securities it holds on behalf of all of its participants. Thus the rules of Parts 2, 3, and 4 of Revised Article 8 apply to the relationship between the issuer and the clearing corporation. If, as is typically the case today, the securities are still represented by certificates, the clearing corporation will be the holder of the security certificate or certificates representing its total holdings. So far as Article 8 is concerned, the relationship between the issuer and the clearing corporation is no different from the relationship between the issuer and any other registered owner.

The relationship between the clearing corporation and its participants is governed by the indirect holding system rules of Part 5. At that level, the clearing corporation is the securities intermediary and the participant is the entitlement holder. If the participant is itself a securities intermediary, such as a broker holding for its customers or a bank acting as a securities custodian, the Part 5 rules apply to its relationship to its own customers. At that level the broker or bank custodian is the securities intermediary and the customer is the entitlement holder. Note that the broker or bank custodian is both an entitlement holder and a securities intermediary ‑‑but is so with respect to different security entitlements. For purposes of Article 8 analysis, the customer's security entitlement against the broker or bank custodian is a different item of property from the security entitlement of the broker or bank custodian against the clearing corporation.

For investors who hold their securities directly, it makes no difference that some other investors hold their interests indirectly. Many investors today choose to hold their securities directly, becoming the registered owners on the books of the issuer and obtaining certificates registered in their names. For such investors, the addition of the new indirect holding system rules to Article 8 is entirely irrelevant. They will continue to deal directly with the issuers, or their transfer agents, under essentially the same rules as in the prior version of Article 8.

The securities holding options available to investors in a particular form of security may depend on the terms of the security. For example, direct holding is frequently not available for new issues of state and local government bonds. At one time, state and local government bonds were commonly issued in bearer form. Today, however, new issues of state and local government bonds must be in registered form and most are issued in what is known as "book‑entry only" form; that is, the issuer specifies that the only person it will directly register as the registered owner is a clearing corporation. Thus, one of the inherent terms of the security is that investors can hold only in the indirect holding system.

2. Treasury securities.

U.S. government securities fall within the definition of security in Article 8 and therefore are governed by Article 8 in the same fashion as any other publicly held debt security, except insofar as Article 8 is preempted by applicable federal law or regulation.

New Treasury securities are no longer issued in certificated form; they can be held only through the book‑entry systems established by the Treasury and Federal Reserve Banks. The Treasury offers a book‑entry system, known as "Treasury Direct" which enables individual investors to have their positions recorded directly on the books of a Federal Reserve Bank, in a fashion somewhat similar to the uncertificated direct holding system contemplated by the 1978 version of Article 8. The governing law for the Treasury Direct system, however, is set out in the applicable Treasury regulations. The Treasury Direct system is not designed for active trading.

The great bulk of Treasury securities are held not through the Treasury Direct system but through a multi‑tiered indirect holding system. The Federal Reserve Banks, acting as fiscal agent for the Treasury, maintain records of the holdings of member banks of the Federal Reserve System, and those banks in turn maintain records showing the extent to which they are holding for themselves or their own customers, including government securities dealers, institutional investors, or smaller banks who in turn may act as custodians for investors. The indirect holding system for Treasury securities was established under federal regulations promulgated in the 1970s. In the 1980s, Treasury released the proposed TRADES regulations that would have established a more comprehensive body of federal commercial law for the Treasury holding system. During the Article 8 revision process, Treasury withdrew these regulations, anticipating that once Revised Article 8 is enacted, it will be possible to base the law for the Treasury system on the new Article 8 rules.

3. Broker‑customer relationships.

Whether the relationship between a broker and its customer is governed by the Article 8 Part 5 rules depends on the nature of the services that the broker performs for the customer.

Some investors use brokers only to purchase and sell securities. These customers take delivery of certificates representing the securities they purchase and hold them in their own names. When they wish to sell, they deliver the certificates to the brokers. The Article 8 Part 5 rules would not affect such customers, because the Part 5 rules deal with arrangements in which investors hold securities through securities intermediaries. The transaction between the customer and broker might be the traditional agency arrangement in which the broker buys or sells on behalf of the customer as agent for an undisclosed principal, or it might be a dealer transaction in which the "broker" as principal buys from or sells to the customer. In either case, if the customer takes delivery and holds the securities directly, she will become the "purchaser" of a "security" whose interest therein is governed by the rules of Parts 2, 3, and 4 of Article 8. If the customer meets the other requirements of Section 8‑303(a), the customer who takes delivery can qualify as a "protected purchaser" who takes free from any adverse claims under Section 8‑303(b). The broker's role in such transactions is primarily governed by non‑Article 8 law. There are only a few provisions of Article 8 that affect the relationship between the customer and broker in such cases. See Sections 8‑108 (broker makes to the customer the warranties of a transferor) and 8‑115 (broker not liable in conversion if customer was acting wrongfully against a third party in selling securities).

Many investors use brokers not only to purchase and sell securities, but also as the custodians through whom they hold their securities. The indirect holding system rules of Part 5 apply to the custodial aspect of this relationship. If a customer purchases a security through a broker and directs the broker to hold the security in an account for the customer, the customer will never become a "purchaser" of a "security" whose interest therein is governed by the rules of Parts 2, 3, and 4 of Article 8. Accordingly, the customer does not become a "protected purchaser" under Section 8‑303. Rather, the customer becomes an "entitlement holder" who has a "security entitlement" to the security against the broker as "securities intermediary." See Section 8‑501. It would make no sense to say that the customer in such a case takes an interest in the security free from all other claims, since the nature of the relationship is that the customer has an interest in common with other customers who hold positions in the same security through the same broker. Section 8‑502, however, does protect an entitlement holder against adverse claims, in the sense that once the entitlement holder has acquired the package of rights that comprise a security entitlement no one else can take that package of rights away by arguing that the transaction that resulted in the customer's acquisition of the security entitlement was the traceable product of a transfer or transaction that was wrongful as against the claimant.

4. Bank deposit accounts; brokerage asset management accounts.

An ordinary bank deposit account would not fall within the definition of "security" in Section 8‑102(a)(15), so the rules of Parts 2, 3, and 4 of Article 8 do not apply to deposit accounts. Nor would the relationship between a bank and its depositors be governed by the rules of Part 5 of Article 8. The Part 5 rules apply to "security entitlements." Section 8‑501(b) provides that a person has a security entitlement when a securities intermediary credits a financial asset to the person's "securities account." "Securities account" is defined in Section 8‑501(a) as "an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset." The definition of securities account plays a key role in setting the scope of Part 5 of Article 8. A person has a security entitlement governed by Part 5 only if the relationship in question falls within the definition of "securities account." The definition of securities account in Section 8‑501(a) excludes deposit accounts from the Part 5 rules of Article 8. One of the basic elements of the relationship between a securities intermediary and an entitlement holder is that the securities intermediary has the duty to hold exactly the quantity of securities that it carries for the account of its customers. See Section 8‑504. The assets that a securities intermediary holds for its entitlement holder are not assets that the securities intermediary can use in its own proprietary business. See Section 8‑503. A deposit account is an entirely different arrangement. A bank is not required to hold in its vaults or in deposit accounts with other banks a sum of money equal to the claims of all of its depositors. Banks are permitted to use depositors' funds in their ordinary lending business; indeed, that is a primary function of banks. A deposit account, unlike a securities account, is simply a debtor‑creditor relationship. Thus a bank or other financial institution maintaining deposit accounts is not covered by Part 5 of Article 8.

Today, it is common for brokers to maintain securities accounts for their customers which include arrangements for the customers to hold liquid "cash" assets in the form of money market mutual fund shares. Insofar as the broker is holding money market mutual fund shares for its customer, the customer has a security entitlement to the money market mutual fund shares. It is also common for brokers to offer their customers an arrangement in which the customer has access to those liquid assets via a deposit account with a bank, whereby shares of the money market fund are redeemed to cover checks drawn on the account. Article 8 applies only to the securities account; the linked bank account remains an account covered by other law. Thus the rights and duties of the customer and the bank are governed not by Article 8, but by the relevant payment system law, such as Article 4 or Article 4A.

5. Trusts.

The indirect holding system rules of Part 5 of Article 8 are not intended to govern all relationships in which one person holds securities "on behalf of" another. Rather, the Part 5 rules come into play only if the relationship in question falls within the definition of securities account in Section 8‑501(a). The definition of securities account serves the important function of ensuring that ordinary trust arrangements are not inadvertently swept into Part 5 of Article 8. Suppose that Bank serves as trustee of a trust for the benefit of Beneficiary. The corpus of the trust is invested in securities and other financial assets. Although Bank is, in some senses, holding securities for Beneficiary, the arrangement would not fall within the definition of securities account. Bank, as trustee, has not undertaken to treat Beneficiary as entitled to exercise all of the rights that comprise the portfolio securities. For instance, although Beneficiary receives the economic benefit of the portfolio securities, Beneficiary does not have the right to direct dispositions of individual trust assets or to exercise voting or other corporate law rights with respect to the individual securities. Thus Bank's obligations to Beneficiary as trustee are governed by ordinary trust law, not by Part 5 of Article 8. Of course, if Bank, as trustee, holds the securities through an intermediary, Part 5 of Revised Article 8 would govern the relationship between Bank, as entitlement holder, and the intermediary through which Bank holds the securities. It is also possible that a different department of Bank acts as the intermediary through which Bank, as trustee, holds the securities. Bank, qua securities custodian, might be holding securities for a large number of customers, including Bank's own trust department. Insofar as Bank may be regarded as acting in different capacities, Part 5 of Article 8 may be relevant to the relationship between the two sides of Bank's business. However, the relationship between Bank as trustee and the beneficiaries of the trust would remain governed by trust law, not Article 8.

6. Mutual fund shares.

Shares of mutual funds are Article 8 securities, whether the fund is organized as a corporation, business trust, or other form of entity. See Sections 8‑102(a)(15) and 8‑103(b). Mutual funds commonly do not issue certificates. Thus, mutual fund shares are typically uncertificated securities under Article 8.

Although a mutual fund is, in a colloquial sense, holding the portfolio securities on behalf of the fund's shareholders, the indirect holding system rules of Part 5 do not apply to the relationship between the fund and its shareholders. The Part 5 rules apply to "security entitlements." Section 8‑501(e) provides that issuance of a security is not establishment of a security entitlement. Thus, because mutual funds shares do fit within the Article 8 definition of security, the relationship between the fund and its shareholders is automatically excluded from the Part 5 rules.

Of course, a person might hold shares in a mutual fund through a brokerage account. Because mutual fund shares are securities, they automatically fall within the broader term "financial asset," so the Part 5 indirect holding system rules apply to mutual fund shares that are held through securities accounts. That is, a person who holds mutual fund shares through a brokerage account could have a security entitlement to the mutual fund shares, just as the person would have a security entitlement to any other security carried in the brokerage account.

7. Stock of closely held corporations.

Ordinary corporate stock falls within the Article 8 definition of security, whether or not it is publicly traded. See Sections 8‑102(a)(15) and 8‑103(a). There is nothing in the new indirect holding system rules of Article 8 that would preclude their application to shares of companies that are not publicly traded. The indirect holding system rules, however, would come into play only if the shares were in fact held through a securities account with a securities intermediary. Since that is typically not the case with respect to shares of closely held corporations, transactions involving those shares will continue to be governed by the traditional rules, as amended, that are set out in Parts 2, 3, and 4 of Article 8, and the corresponding provisions of Article 9. The simplification of the Article 8 rules on uncertificated securities may, however, make the alternative of dispensing with certificates more attractive for closely held corporations.

8. Partnership interests and limited liability company shares.

Interests in partnerships or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. See Section 8‑103(c). The issuers, however, may if they wish explicitly "opt‑in" by specifying that the interests or shares are securities governed by Article 8. Even though interests in partnerships or shares of limited liability companies do not generally fall within the category of "security" in Article 8, they would fall within the broader term "financial asset." Accordingly, if such interests are held through a securities account with a securities intermediary, the indirect holding system rules of Part 5 apply, and the interest of a person who holds them through such an account is a security entitlement.

9. Bankers' acceptances, commercial paper, and other money market instruments.

Money market instruments, such as commercial paper, bankers' acceptances, and certificates of deposit, are good examples of a form of property that may fall within the definition of "financial asset," even though they may not fall within the definition of "security." Section 8‑103(d) provides that a writing that meets the definition of security certificate under Section 8‑102(a)(15) is governed by Article 8, even though it also fits within the definition of "negotiable instrument" in Article 3.

Some forms of short term money market instruments may meet the requirements of an Article 8 security, while others may not. For example, the Article 8 definition of security requires that the obligation be in registered or bearer form. Bankers' acceptances are typically payable "to order," and thus do not qualify as Article 8 securities. Thus, the obligations of the immediate parties to a bankers' acceptance are governed by Article 3, rather than Article 8. That is an entirely appropriate classification, even for those bankers' acceptance that are handled as investment media in the securities markets, because Article 8, unlike Article 3, does not contain rules specifying the standardized obligations of parties to instruments. For example, the Article 3 rules on the obligations of acceptors and drawers of drafts are necessary to specify the obligations represented by bankers' acceptances, but Article 8 contains no provisions dealing with these issues.

Immobilization through a depository system is, however, just as important for money market instruments as for traditional securities. Under the prior version of Article 8, the rules on the depository system, set out in Section 8‑320, applied only to Article 8 securities. Although some forms of money market instruments could be fitted within the language of the Article 8 definition of "security," this is not true for bankers' acceptances. Accordingly, it was not thought feasible to make bankers' acceptances eligible for deposit in clearing corporations under the prior version of Article 8. Revised Article 8 solves this problem by separating the coverage of the Part 5 rules from the definition of security. Even though a bankers' acceptance or other money market instrument is an Article 3 negotiable instrument rather than an Article 8 security, it would still fall within the definition of financial asset in Section 8‑102(a)(9). Accordingly, if the instrument is held through a clearing corporation or other securities intermediary, the rules of Part 5 of Article 8 apply.

10. Repurchase agreement transactions.

Repurchase agreements are an important form of transaction in the securities business, particularly in connection with government securities. Repos and reverse repos can be used for a variety of purposes. The one that is of particular concern for purposes of commercial law rules is the use of repurchase agreements as a form of financing transaction for government securities dealers. Government securities dealers typically obtain intra‑day financing from their clearing banks, and then at the end of the trading day seek overnight financing from other sources to repay that day's advances from the clearing bank. Repos are the principal source of this financing. The dealer ("repo seller") sells securities to the financing source ("repo buyer") for cash, and at the same time agrees to repurchase the same or like securities the following day, or at some other brief interval. The sources of the financing include a variety of entities seeking short term investments for surplus cash, such as pension funds, business corporations, money market funds, and banks. The pricing may be computed in various ways, but in essence the price at which the dealer agrees to repurchase the securities exceeds the price paid to the dealer by an amount equivalent to interest on the funds.

The transfer of the securities from a securities dealer as repo seller to a provider of funds as repo buyer can be effected in a variety of ways. The repo buyer might be willing to allow the repo seller to keep the securities "in its hands," relying on the dealer's representation that it will hold them on behalf of the repo buyer. In the jargon of the trade, these are known as "hold‑in‑custody repos" or "HIC repos." At the other extreme, the repo buyer might insist that the dealer "hand over" the securities so that in the event that the dealer fails and is unable to perform its obligation to repurchase them, the repo buyer will have the securities "in its hands." The jargon for these is "delivered‑out repos." A wide variety of arrangements between these two extremes might be devised, in which the securities are "handed over" to a third party with powers concerning their disposition allocated between the repo seller and repo buyer in a variety of ways.

Specification of the rights of repo buyers is complicated by the fact that the transfer of the interest in securities from the repo seller to the repo buyer might be characterized as an outright sale or as the creation of a security interest. Article 8 does not attempt to specify any categorical rules on that issue.

Article 8 sets out rules on the rights of parties who have implemented securities transactions in certain ways. It does not, however, deal with the legal characterization of the transactions that are implemented through the Article 8 mechanisms. Rather, the Article 8 rules apply without regard to the characterization of transactions for other purposes. For example, the Article 8 rules for the direct holding system provide that a person who takes delivery of a duly indorsed security certificate for value and without notice of adverse claims takes free from any adverse claims. That rule applies without regard to the character of the transaction in which the security certificate was delivered. It applies both to delivery upon original issue and to delivery upon transfer. It applies to transfers in settlement of sales and to transfers in pledge. Similarly, the Article 8 indirect holding system rules, such as the adverse claim cut‑off rules in Sections 8‑502 and 8‑510, apply to the transactions that fall within their terms, whether those transactions were sales, secured transactions, or something else.

Repos involve transfers of interests in securities. The Article 8 rules apply to transfers of securities in repos, just as they apply to transfers of securities in any other form of transaction. The transfer of the interest in securities from the repo seller to the repo buyer might be characterized as an outright sale or as the creation of a security interest. Article 8 does not determine that question. The rules of Revised Article 8 have, however, been drafted to minimize the possibility that disputes over the characterization of the transfer in a repo would affect substantive questions that are governed by Article 8. See, e.g., Section 8‑510 and Comment 4 thereto.

11. Securities lending transactions.

In a typical securities lending transaction, the owner of securities lends them to another person who needs the securities to satisfy a delivery obligation. For example, when a customer of a broker sells a security short, the broker executes an ordinary trade as seller and so must deliver the securities at settlement. The customer is "short" against the broker because the customer has an open obligation to deliver the securities to the broker, which the customer hopes to be able to satisfy by buying in the securities at a lower price. If the short seller's broker does not have the securities in its own inventory, the broker will borrow them from someone else. The securities lender delivers the securities to the borrowing broker, and the borrowing broker becomes contractually obligated to redeliver a like quantity of the same security. Securities borrowers are required to provide collateral, usually government securities, to assure performance of their redelivery obligation.

The securities lender does not retain any property interest in the securities that are delivered to the borrower. The transaction is an outright transfer in which the borrower obtains full title. The whole point of securities lending is that the borrower needs the securities to transfer them to someone else. It would make no sense to say that the lender retains any property interest in the securities it has lent. Accordingly, even if the securities borrower defaults on its redelivery obligation, the securities lender has no property interest in the original securities that could be asserted against any person to whom the securities borrower may have transferred them. One need not look to adverse claim cut‑off rules to reach that result; the securities lender never had an adverse claim. The securities borrower's default is no different from any other breach of contract. The securities lender's protection is its right to foreclose on the collateral given to secure the borrower's redelivery obligation. Perhaps the best way to understand securities lending is to note that the word "loan" in securities lending transactions is used in the sense it carries in loans of money, as distinguished from loans of specific identifiable chattels. Someone who lends money does not retain any property interest in the money that is handed over to the borrower. To use civil law terminology, securities lending is mutuum, rather than commodatum. See Story on Bailments, "6 and 47.

12. Traded stock options.

Stock options issued and cleared through the Options Clearing Corporation ("OCC") are a good example of a form of investment vehicle that is treated as a financial asset to which the Part 5 rules apply, but not as an Article 8 security to which Parts 2, 3, and 4 apply. OCC carries on its books the options positions of the brokerage firms which are clearing members of OCC. The clearing members in turn carry on their books the options positions of their customers. The arrangements are structurally similar to the securities depository system. In the options structure, however, there is no issuer separate from the clearing corporation. The financial assets held through the system are standardized contracts entitling the holder to purchase or sell a certain security at a set price. Rather than being an interest in or obligation of a separate issuer, an option is a contractual right against the counter‑party. In order to assure performance of the options, OCC interposes itself as counter‑party to each options trade. The rules of Parts 2, 3, and 4 of this Article, however, do not well describe the obligations and rights of OCC. On the other hand, the rules of Part 5, and the related Article 9 rules on security interests and priorities, do provide a workable legal framework for the commercial law analysis of the rights of the participants in the options market. Accordingly, publicly traded securities options are included within the definition of "financial asset," but not "security." See Section 8‑103(e). Thus, although OCC would not be an issuer of a security for purposes of this Article, it would be a clearing corporation, against whom its clearing members have security entitlements to the options positions. Similarly, the clearing members' customers have security entitlements against the clearing members. Traded stock options are also a good illustration of the point that the classification issues under Article 8 are very different from classification under other law, such as the federal securities laws. See Section 8‑102(d). Stock options are treated as securities for purposes of federal securities laws, but not for purposes of Article 8.

13. Commodity futures.

Section 8‑103(f) provides that a "commodity contract" is not a security or a financial asset. Section 9‑102(a)(15) defines commodity contract to include commodity futures contracts, commodity options, and options on commodity futures contracts that are traded on or subject to the rules of a board of trade that has been designated as a contract market for that contract pursuant to the federal commodities laws. Thus, commodity contracts themselves are not Article 8 securities to which the rules of Parts 2, 3, and 4 apply, nor is the relationship between a customer and a commodity futures commission merchant governed by the Part 5 rules of Article 8. Commodity contracts, however, are included within the Article 9 definition of "investment property." Thus security interests in commodity positions are governed by essentially the same set of rules as security interests in security entitlements.

14. "Whatever else they have or may devise."

The classification question posed by the above‑captioned category of investment products and arrangements is among the most difficult‑‑and important‑‑issue raised by the Article 8 revision process. Rapid innovation is perhaps the only constant characteristic of the securities and financial markets. The rules of Revised Article 8 are intended to be sufficiently flexible to accommodate new developments.

A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. It is not possible to answer in the abstract the question of how such interests are treated under Article 8, because the variety of such products is limited only by human imagination and current regulatory structures. At this general level, however, one can note that there are at least three possible treatments under Article 8 of the relationship between the institution which creates the interests and the persons who hold them. (Again, it must be borne in mind that the Article 8 classification issue may be different from the classification question posed by federal securities law or other regulation.) First, creation of the new interests in the underlying assets may constitute issuance of a new Article 8 security. In that case the relationship between the institution that created the interest and the persons who hold them is not governed by the Part 5 rules, but by the rules of Parts 2, 3, and 4. See Section 8‑501(e). That, for example, is the structure of issuance of mutual fund shares. Second, the relationship between the entity creating the interests and those holding them may fit within the Part 5 rules, so that the persons are treating as having security entitlements against the institution with respect to the underlying assets. That, for example, is the structure used for stock options. Third, it may be that the creation of the new interests in the underlying assets does not constitute issuance of a new Article 8 security, nor does the relationship between the entity creating the interests and those holding them fit within the Part 5 rules. In that case, the relationship is governed by other law, as in the case of ordinary trusts.

The first of these three possibilities‑‑that the creation of the new interest is issuance of a new security for Article 8 purposes‑‑is a fairly common pattern. For example, an American depositary receipt facility does not maintain securities accounts but issues securities called ADRs in respect of foreign securities deposited in such facility. Similarly, custodians of government securities which issue receipts, certificates, or the like representing direct interests in those securities (sometimes interests split between principal and income) do not maintain securities accounts but issue securities representing those interests. Trusts holding assets, in a variety of structured and securitized transactions, which issue certificates or the like representing "pass‑through" or undivided beneficial interests in the trust assets, do not maintain securities accounts but issue securities representing those interests.

In analyzing these classification questions, courts should take care to avoid mechanical jurisprudence based solely upon exegesis of the wording of definitions in Article 8. The result of classification questions is that different sets of rules come into play. In order to decide the classification question it is necessary to understand fully the commercial setting and consider which set of rules Best fits the transaction. Rather than letting the choice of rules turn on interpretation of the words of the definitions, the interpretation of the words of the definitions should turn on the suitability of the application of the substantive rules.

IV. CHANGES FROM PRIOR (1978) VERSION OF ARTICLE 8

A.

Table of Disposition of Sections in Prior Version

Article 8 (1978) Revised Articles 8 and 9

8‑101 8‑101

8‑102(1)(a) 8‑102(a)(4) & (15)

8‑102(1)(b) 8‑102(a)(15) & (18)

8‑102(1)(c) 8‑102(a)(15)

8‑102(1)(d) 8‑102(a)(13)

8‑102(1)(e) 8‑102(a)(2)

8‑102(2) 8‑202(b)(1)

8‑102(3) 8‑102(a)(5)

8‑102(4) omitted, see Revision Note 1

8‑102(5) 8‑102(b)

8‑102(6) 8‑102(c)

8‑103 8‑209

8‑104 8‑210

8‑105(1) omitted, see Revision Note 8

8‑105(2) omitted, see Revision Note 4

8‑105(3) 8‑114

8‑106 8‑110

8‑107 omitted, see Revision Note 8

8‑108 omitted, see Revision Note 5

8‑201 8‑201

8‑202 8‑202; transaction statement provisions omitted, see

Revision Note 4

8‑203 8‑203

8‑204 8‑204; transaction statement provisions omitted, see

Revision Note 4

8‑205 8‑205; transaction statement provisions omitted, see

Revision Note 4

8‑206 8‑206; transaction statement provisions omitted, see

Revision Note 4

8‑207 8‑207; registered pledge provisions omitted, see

Revision Note 5

8‑208 8‑208; transaction statement provisions omitted, see

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8‑301 8‑302(a) & (b)

8‑302(1) 8‑303(a)

8‑302(2) 8‑102(a)(1)

8‑302(3) 8‑303(b)

8‑302(4) 8‑302(c)

8‑303 8‑102(a)(3)

8‑304(1) 8‑105(d)

8‑304(2) omitted, see Revision Note 4

8‑304(3) 8‑105(b)

8‑305 8‑105(c)

8‑306(1) 8‑108(f)

8‑306(2) 8‑108(a)

8‑306(3) 8‑108(g)

8‑306(4) 8‑108(h)

8‑306(5) 8‑108(e)

8‑306(6) 8‑306(h)

8‑306(7) 8‑108(b), 8‑306(h)

8‑306(8) omitted, see Revision Note 5

8‑306(9) 8‑108(c)

8‑306(10) 8‑108(i)

8‑307 8‑304(d)

8‑308(1) 8‑102(a)(11), 8‑107

8‑308(2) 8‑304(a)

8‑308(3) 8‑304(b)

8‑308(4) 8‑102(a)(12)

8‑308(5) 8‑107 & 8‑305(a)

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8‑308(7) 8‑107

8‑308(8) 8‑107

8‑308(9) 8‑304(f) & 8‑305(b)

8‑308(10) 8‑107

8‑308(11) 8‑107

8‑309 8‑304(c)

8‑310 8‑304(e)

8‑311(a) omitted, see 8‑106(b)(2), 8‑301(b)(1), 8‑303

8‑311(b) 8‑404

8‑312 8‑306

8‑313(1)(a) omitted, see Revision Note 2; see also 8‑301(a)(1) &

(2)

8‑313(1)(b) omitted, see Revision Note 2; see also 8‑301(b)(1) &

(2)

8‑313(1)(c) omitted, see Revision Note 2; see also 8‑301(a)(3)

8‑313(1)(d) omitted, see Revision Note 2; see also 8‑501(b)

8‑313(1)(e) omitted, see Revision Note 2; see also 8‑301(a)(2)

8‑313(1)(f) omitted, see Revision Note 2; see also 8‑301(b)(2)

8‑313(1)(g) omitted, see Revision Notes 1 & 2; see also

8‑501(b), 8‑111

8‑313(1)(h)‑(j) omitted, see Revision Note 2; see also 9‑203

8‑313(2) omitted, see Revision Note 2; see also 8‑503

8‑313(3) omitted, see Revision Note 2

8‑313(4) 8‑102(a)(14)

8‑314 omitted, see Revision Note 8

8‑315 omitted, see Revision Note 8

8‑316 8‑307

8‑317 8‑112

8‑318 8‑115

8‑319 omitted, see 8‑113 and Revision Note 7

8‑320 omitted, see Revision Note 1

8‑321 omitted, see 9‑203, 9‑303, 9‑312, 9‑314

8‑401 8‑401

8‑402 8‑402, see Revision Note 6

8‑403 8‑403, see Revision Note 6

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8‑405(1) 8‑406

8‑405(2) 8‑405(a)

8‑405(3) 8‑405(b)

8‑406 8‑407

8‑407 omitted, see Revision Note 8

8‑408 omitted, see Revision Note 4

B. Revision Notes

1. Provisions of former Article 8 on clearing corporations.

The keystone of the treatment of the indirect holding system in the prior version of Article 8 was the special provision on clearing corporations in Section 8‑320. Section 8‑320 was added to Article 8 in 1962, at the very end of the process that culminated in promulgation and enactment of the original version of the Code. The key concepts of the original version of Article 8 were "bona fide purchaser" and "delivery." Under Section 8‑302 (1962) one could qualify as a "bona fide purchaser" only if one had taken delivery of a security, and Section 8‑313 (1962) specified what counted as a delivery.

Section 8‑320 was added to take account of the development of the system in which trades can be settled by netted book‑entry movements at a depository without physical deliveries of certificates. Rather than reworking the basic concepts, however, Section 8‑320 brought the depository system within Article 8 by definitional fiat. Subsection (a) of Section 8‑320 (1962) stated that a transfer or pledge could be effected by entries on the books of a central depository, and subsection (b) stated that such an entry "has the effect of a delivery of a security in bearer form or duly indorsed in blank." In 1978, Section 8‑320 was revised to conform it to the general substitution of the concept of "transfer" for "delivery," but the basic structure remained the same. Under the 1978 version of Article 8, the only book‑entry transfers that qualified the transferee for bona fide purchaser rights were those made on the books of a clearing corporation. See Sections 8‑302(1)(c), 8‑313(1)(g), and 8‑320. Thus, for practical purposes, the indirect holding system rules of the prior version of Article 8 required that the securities be held by a clearing corporation in accordance with the central depository rules of Section 8‑320.

Some of the definitional provisions concerning clearing corporation in the prior version of Article 8 seem to have conflated the commercial law rules on the effect of book‑entry transactions with issues about the regulation of entities that are acting as clearing corporations. For example, the Section 8‑320 rules that gave effect to book‑entry transfers applied only if the security was "in the custody of the clearing corporation, another clearing corporation, [or] a custodian bank." "Custodian bank" was defined in Section 8‑102(4) as "a bank or trust company that is supervised and examined by state or federal authority having supervision over banks and is acting as custodian for a clearing corporation." Although this was probably inadvertent, these definitional provisions have operated as an obstacle to the development of clearing arrangements for global trading, since they effectively precluded clearing corporations from using foreign banks as custodians.

Revised Article 8 is based on the view that Article 8 is not the proper place for regulatory decisions about whether certain sorts of financial institutions should or should not be permitted to engage in a particular aspect of the securities business, such as acting as a clearing corporation, or how they should be permitted to conduct that business. Rather, Article 8 should deal only with the commercial law questions of what duties and rights flow from doing business as a clearing corporation, leaving it to other regulatory law to decide which entities should be permitted to act as clearing corporations, and to regulate their activities. Federal securities laws now establish a detailed regulatory structure for clearing corporations; there is no need for Article 8 to duplicate parts of that structure. Revised Article 8 deletes all provision of the prior version which had the effect of specifying how clearing corporations should conduct their operations. For example, Revised Article 8 deletes the definition of "custodian bank," which operated in the prior version only as a regulatory restriction on how clearing corporations could hold securities.

In general, the structure of Revised Article 8 is such that there is relatively little need for special provisions on clearing corporations. Book‑entry transactions effected through clearing corporations are treated under the same rules in Part 5 as book‑entry transactions effected through any other securities intermediary. Accordingly, Revised Article 8 has no direct analog of the special provisions in Section 8‑320 on transfers on the books of clearing corporations.

2. Former Section 8‑313‑‑"Transfer."

Section 8‑313 of the 1978 version of Article was extremely complicated, because it attempted to cover many different issues. The following account of the evolution of Section 8‑313 may assist in understanding why a different approach is taken in Revised Article 8. This explanation is, however, intended not as an actual account of historical events, but as a conceptual reconstruction, devised from the perspective of, and with the benefit of, hindsight.

The original objective of Article 8 was to ensure that certificates representing investment securities would be "negotiable" in the sense that purchasers would be protected by the bona fide purchaser rules. The requirements for bona fide purchaser status were that the purchaser had to (i) take delivery of the security and (ii) give value in good faith and without notice of adverse claims. Section 8‑313 specified what counted as a "delivery," and Section 8‑302 specified the other requirements.

The 1978 amendments added provisions on uncertificated securities, but the basic organizational pattern was retained. Section 8‑302 continued to state the requirements of value, good faith, and lack of notice for good faith purchase, and Section 8‑313 stated the mechanism by which the purchase had to be implemented. Delivery as defined in the original version of Section 8‑313 had a meaning similar to the concept known in colloquial securities jargon as "good delivery"; that is, physical delivery with any necessary indorsement. Although the word "delivery" has now come to be used in securities parlance in a broader sense than physical delivery, when the provisions for uncertificated securities were added it was thought preferable to use another word. Thus, the word "transfer" was substituted for "delivery" in Section 8‑313.

The 1978 amendments also moved the rules governing security interests in securities from Article 9 to Article 8, though the basic conceptual structure of the common law of pledge was retained. Since a pledge required a delivery, and since the term transfer had been substituted for delivery, the 1978 amendments provided that in order to create a security interest there must be a "transfer," in the defined Article 8 sense, from the debtor to the secured party. Accordingly, provisions had to be added to Section 8‑313 so that any of the steps that should suffice to create a perfected security interest would be deemed to constitute a "transfer" within the meaning of Section 8‑313. Thus, the Section 8‑313 rules on "transfer," which had in the previous version dealt only with what counted as a delivery that qualified one for bona fide purchaser status, became the statutory locus for all of the rules on creation and perfection of security interests in securities. Accordingly the rather elaborate rules of subsections (1)(h), (1)(i), and (1)(j) were added.

Having expanded Section 8‑313 to the point that it served as the rule specifying the formal requirements for transfer of all significant forms of interests in securities, it must have seemed only logical to take the next step and make the Section 8‑313 rules the exclusive means of transferring interests in securities. Thus, while the prior version had stated that "Delivery to a purchaser occurs when . . .", the 1978 version stated that "Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only. . . ." Having taken that step, however, it then became necessary to ensure that anyone who should be regarded as having an interest in a security would be covered by some provision of Section 8‑313. Thus, the provisions of subsection (1)(d)(ii) and (iii) were added to make it possible to say that the customers of a securities intermediary who hold interests in securities held by the intermediary in fungible bulk received "transfers."

Section 8‑313(1)(d) was the key provision in the 1978 version dealing with the indirect holding system at the level below securities depositories. It operated in essentially the same fashion as Section 8‑320; that is, it stated that when a broker or bank holding securities in fungible bulk makes entries on its books identifying a quantity of the fungible bulk as belonging to the customer, that action is treated as a "transfer"‑‑in the special Section 8‑313 sense‑‑of an interest in the security from the intermediary to the customer.

Revised Article 8 has no direct analog of the 1978 version of Section 8‑313. The rules on secured transactions have been returned to Article 9, so subsections of Section 8‑313 (1978) dealing with security interests are deleted from Article 8. Insofar as portions of Section 8‑313 (1978) were designed to specify the formal requirements for transferees to qualify for protection against adverse claims, their place is taken by Revised Section 8‑301, which defines "delivery," in a fashion somewhat akin to the pre‑1978 version of Section 8‑313. The descendant of the provisions of Section 8‑313 (1978) dealing with the indirect holding system is Revised Section 8‑501 which specifies when a person acquires a security entitlement. Section 8‑501, however, is based on a different analysis of the transaction in which a customer acquires a position in the indirect holding system. The transaction is not described as a "transfer" of an interest in some portion of a fungible bulk of securities held by the securities intermediary but as the creation of a security entitlement. Accordingly, just as Revised Article 8 has no direct analog of the Section 8‑320 rules on clearing corporation transfers, it has no direct analog of the Section 8‑313(1) rules on "transfers" of interests in securities held in fungible bulk.

3. Uncertificated securities provisions.

Given the way that securities holding practices have evolved, the sharp distinction that the 1978 version of Article 8 drew between certificated securities and uncertificated securities has become somewhat misleading. Since many provisions of the 1978 version had separate subsections dealing first with certificated securities and then with uncertificated securities, and since people intuitively realize that the volume of trading in the modern securities markets could not possibly be handled by pushing around certificates, it was only natural for a reader of the statute to conclude that the uncertificated securities provisions of Article 8 were the basis of the book‑entry system. That, however, is not the case. Although physical delivery of certificates plays little role in the settlement system, most publicly traded securities are still, in legal theory, certificated securities. To use clearance and settlement jargon, the book‑entry securities holding system has used "immobilization" rather than " dematerialization."

The important legal and practical difference is between the direct holding system, in which the beneficial owners have a direct relationship with the issuer, and the indirect holding system, in which securities are held through tiers of securities intermediaries. Accordingly, in Revised Article 8 the contrast between certificated securities and uncertificated securities has been minimized or eliminated as much as possible in stating the substantive provisions.

4. Transaction statements.

Although the 1978 provisions on uncertificated securities contemplated a system in which there would be no definitive certificates as reifications of the underlying interests or obligations, the 1978 amendments did not really dispense with all requirements of paper evidence of securities holding. The 1978 amendments required issuers of uncertificated securities to send paper "transaction statements" upon registration of transfer. Section 8‑408 regulated the content and format of these transaction statements in considerable detail. The statements had to be in writing, include specific information, and contain a conspicuous legend stating that "This statement is merely a record of the rights of the addressee as of the time of its issuance. Delivery of this statement, of itself, confers no rights on the recipient. This statement is neither a negotiable instrument nor a security." Issuers were required to send statements when any transfer was registered (known as "initial transaction statements") and also were required to send periodic statements at least annually and also upon any security holder's reasonable request. Fees were regulated to some extent, in that Section 8‑408(8) specified that if periodic statements were sent at least quarterly, the issuer could charge for statements requested by security holders at other times.

The detailed specification of reporting requirements for issuers of uncertificated securities was quite different from the treatment of securities intermediaries. Though the prior version of Article 8 did require non‑clearing corporation securities intermediaries to send confirmations of transfers‑‑a requirement deleted in Revised Article 8‑‑it did not regulate their content or format. Article 8 has never imposed periodic reporting requirements on securities intermediaries. Thus, reporting requirements for the indirect holding system were left to agreements and regulatory authorities, while reporting requirements for a book‑entry direct holding system were imposed by statute.

Securities holding systems based on transaction statements of the sort contemplated by the 1978 amendments have not yet evolved to any major extent‑‑indeed, the statutory specification of the details of the information system may itself have acted as an impediment to the evolution of a book‑ entry direct system. Accordingly, Revised Article 8 drops the statutory requirements concerning transaction statements. The record keeping and reporting obligations of issuers of uncertificated securities would be left to agreement and other law, as is the case today for securities intermediaries.

In the 1978 version, the Part 2 rules concerning transfer restrictions, issuers' defenses, and the like were based on the assumption that transaction statements would be used in a fashion analogous to traditional security certificates. For example, Sections 8‑202 and 8‑204 specified that the terms of a security, or any restrictions on transfer imposed by the issuer, had to be noted on the transaction statement. Revised Article 8 deletes all such references to transaction statements. The terms of securities, or of restrictions of transfer, would be governed by whatever law or agreement specifies these matters, just as is the case for various other forms of business entities, such as partnerships, that have never issued certificates representing interests. Other Part 2 rules, such as Sections 8‑205, 8‑206, and 8‑208, attempted to state rules on forgery and related matters for transactions statements. Since Revised Article 8 does not specify the format for information systems for uncertificated securities, there is no point in attempting to state rules on the consequences of wrongful information transmission in the particular format of written statements authenticated by signatures.

5. Deletion of provisions on registered pledges.

The 1978 version of Article 8 also added detailed provisions concerning "registered pledges" of uncertificated securities. Revised Article 8 adopts a new system of rules for security interests in securities, for both the direct and indirect holding systems that make it unnecessary to have special statutory provisions for registered pledges of uncertificated securities.

The reason that the 1978 version of Article 8 created this concept was that if the only means of creating security interests was the pledge, it seemed necessary to provide some substitute for the pledge in the absence of a certificate. The point of the registered pledge was, presumably, that it permitted a debtor to grant a perfected security interest in securities, yet still keep the securities in the debtor's own name for purposes of dividends, voting, and the like. The concept of registered pledge has, however, been thought troublesome by many legal commentators and securities industry participants. For example, in Massachusetts where many mutual funds have their headquarters, a non‑uniform amendment was enacted to permit the issuer of an uncertificated security to refuse to register a pledge and instead issue a certificate to the owner that the owner could then pledge by ordinary means.

Under the 1978 version of Article 8, if an issuer chose to issue securities in uncertificated form, it was also required by statute to offer a registered pledge program. Revised Articles 8 and 9 take a different approach. All of the provisions dealing with registered pledges have been deleted. This does not mean, however, that issuers cannot offer such a service. The control rules of Revised Section 8‑106 and the related priority provisions in Article 9 establish a structure that permits issuers to develop systems akin to the registered pledge device, without mandating that they do so, or legislating the details of the system. In essence, the registered pledge or control device amounts to a record keeping service. A debtor can always transfer securities to its lender. In a registered pledge or control agreement arrangement, the issuer keeps track of which securities the secured party holds for its own account outright, and which securities it holds in pledge from its debtors.

Under the rules of Revised Articles 8 and 9, the registered pledge issue can easily be left to resolution by the market. The concept of control is defined in such fashion that if an issuer or securities intermediary wishes to offer a service akin to the registered pledge device it can do so. The issuer or securities intermediary would offer to enter into agreements with the debtor and secured party under which it would hold the securities for the account of the debtor, but subject to instructions from the secured party. The secured party would thereby obtain control assuring perfection and priority of its lien.

Even if such arrangements are not offered by issuers, persons who hold uncertificated securities will have several options for using them as collateral for secured loans. Under the new rules, filing is a permissible method of perfection, for debtors other than securities firms. A secured party who relies on filing is, of course, exposed to the risk that the debtor will double finance and grant a later secured lender a security interest under circumstances that give that lender control and hence priority. If the lender is unwilling to run that risk, the debtor can transfer the securities outright to the lender on the books of the issuer, though between the parties the debtor would be the owner and the lender only a secured party. That, of course, requires that the debtor trust the secured party not to dispose of the collateral wrongfully, and the debtor may also need to make arrangements with the secured party to exercise benefits of ownership such as voting and receiving distributions.

It may well be that both lenders and borrowers would prefer to have some arrangement, such as the registered pledge device of current law, that permits the debtor to remain as the registered owner entitled to vote and receive dividends but gives the lender exclusive power to order their disposition. The approach taken in this revision is that if there is a genuine demand for such arrangements, it can be met by the market. The difficulty with the approach of present Article 8 is that it mandates that any issuer that wishes to issue securities in uncertificated form must also offer this record keeping service. That obligation may well have acted as a disincentive to the development of uncertificated securities. Thus, the deletion of the mandated registered pledge provisions is consistent with the principle of neutrality toward the evolution of securities holding practices.

6. Former Section 8‑403‑‑Issuer's Duty as to Adverse Claims.

Section 8‑403 of the prior version of Article 8 dealt with the obligations of issuers to adverse claimants. The starting point of American law on issuers' liability in such circumstances is the old case of Lowry v. Commercial & Farmers' Bank, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), under which issuers could be held liable for registering a transfer at the direction of a registered owner who was acting wrongfully as against a third person in making the transfer. The Lowry principle imposed onerous liability on issuers, particularly in the case of transfers by fiduciaries, such as executors and trustees. To protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers to assure themselves that the fiduciaries were acting rightfully. As a result, fiduciary stock transfers were cumbersome and time consuming.

In the present century, American law has gradually moved away from the Lowry principle. Statutes such as the Uniform Fiduciaries Act, the Model Fiduciary Stock Transfer Act, and the Uniform Act for the Simplification of Fiduciary Security Transfers sought to avoid the delays in stock transfers that could result from issuers' demands for documentation by limiting the issuer's responsibility for transfers in breach of the registered owner's duty to others. Although these statutes provided that issuers had no duty of inquiry to determine whether a fiduciary was acting rightfully, they all provided that an issuer could be liable if the issuer acted with notice of third party claims.

The prior version of Article 8 followed the same approach as the various fiduciary transfer statutes. Issuers were not required to seek out information from which they could determine whether a fiduciary was acting properly, but they were liable if they registered a transfer with notice that the fiduciary was acting improperly. Former Section 8‑308(11) said that the failure of a fiduciary to comply with a controlling instrument or failure to obtain a court approval required under local law did not render the indorsement or instruction unauthorized. However, if a fiduciary was in fact acting improperly, then the beneficiary would be treated as an adverse claimant. See Section 8‑302(2) (1978) and Comment 4. Former Section 8‑403 specified that if written notice of an adverse claim had been sent to the issuer, the issuer "shall inquire into the adverse claim" before registering a transfer on the indorsement or instruction of the registered owner. The issuer could "discharge any duty of inquiry by any reasonable means," including by notifying the adverse claimant that the transfer would be registered unless the adverse claimant obtained a court order or gave an indemnity bond.

Revised Article 8 rejects the Lowry principle altogether. It provides that an issuer is not liable for wrongful registration if it acts on an effective indorsement or instruction, even though the issuer may have notice of adverse claims, so long as the issuer has not been served with legal process and is not acting in collusion with the wrongdoer in registering the transfer. See Revised Section 8‑404 and Comments thereto. The provisions of prior Section 8‑403 specifying that issuers had a duty to investigate adverse claims of which they had notice are deleted.

Revised Article 8 also deletes the provisions set out in Section 8‑403(3) of prior law specifying that issuers did not have a duty to inquire into the rightfulness of transfers by fiduciaries. The omission of the rules formerly in Section 8‑403(3) does not, of course, mean that issuers would be liable for acting on the instruction of fiduciaries in the circumstances covered by former Section 8‑403(3). Former Section 8‑403(3) assumed that issuers would be liable if they registered a transfer with notice of an adverse claim. Former Section 8‑403(3) was necessary only to negate any inference that knowledge that a transfer was initiated by a fiduciary might give constructive notice of adverse claims. Under Section 8‑404 of Revised Article 8, mere notice of adverse claims does not impose duties on the issuer. Accordingly the provisions included in former Section 8‑403(3) are unnecessary.

Although the prior version of Article 8 included provisions similar or identical to those set out in the Uniform Act for the Simplification of Fiduciary Security Transfers and similar statutes, most states retained these statutes at the time the Uniform Commercial Code was adopted. These statutes are based on a premise different from Revised Article 8. The fiduciary simplification acts are predicated on the assumption that an issuer would be liable to an adverse claimant if the issuer had notice. These statutes seek only to preclude any inference that issuers have such notice when they register transfers on the instructions of a fiduciary. Revised Article 8 is based on the view that a third party should not be able to interfere with the relationship between an issuer and its registered shareholders unless the claimant obtains legal process. Since notice of an adverse claim does not impose duties on an issuer under Revised Article 8, the Uniform Act for the Simplification of Fiduciary Security Transfers, or similar statutes, should be repealed upon enactment of Revised Article 8.

7. Former Section 8‑319‑‑Statute of Frauds.

Revised Article 8 deletes the special statute of frauds provision for securities contracts that was set out in former Section 8‑319. See Revised Section 8‑113. Most of the litigation involving the statute of frauds rule of the prior version of Article 8 involved informal transactions, rather than transactions on the organized securities markets. Typical cases were those in which an employee or former employee of a small enterprise sued to enforce an alleged promise that he or she would receive an equity interest in the business. The usual commercial policies relating to writings in contracts for the sale of personal property are at most tangentially implicated in such cases. There was a rather large and complex body of case law dealing with the applicability of Section 8‑319 to cases of this sort. It seems doubtful that the cost of litigating these issues was warranted by whatever protections the statute of frauds offered against fraudulent claims.

Subsection (c) of former Section 8‑319 provided that the statute of frauds bar did not apply if a written confirmation was sent and the recipient did not seasonably send an objection. That provision, however, presumably would not have had the effect of binding a broker's customer to the terms of a trade for which confirmation had been sent though the customer had not objected within 10 days. In the first place, the relationship between a broker and customer is ordinarily that of agent and principal; thus the broker is not seeking to enforce a contract for sale of a security, but to bind its principal for action taken by the broker as agent. Former Section 8‑319 did not by its terms apply to the agency relationship. Moreover, even if former Section 8‑319(c) applied, it is doubtful that it, of its own force, had the effect of precluding the customer from disputing whether there was a contract or what the terms of the contract were. Former Section 8‑319(c) only removed the statute of frauds as a bar to enforcement; it did not say that there was a contract or that the confirmation had the effect of excluding other evidence of its terms. Thus, deletion of former Section 8‑319 does not change the law one way or the other on whether a customer who fails to object to a written confirmation is precluded from denying the trade described in the confirmation, because that issue was never governed by former Section 8‑319(c).

8. Miscellaneous.

Prior Section 8‑105. Revised Article 8 deletes the statement found in Section 8‑105(1) of the prior version that certificated securities "are negotiable instruments." This provision was added very late in the drafting process of the original Uniform Commercial Code. Apparently the thought was that it might be useful in dealing with potential transition problems arising out of the fact that bonds were then treated as negotiable instruments under the Uniform Negotiable Instruments Law. During that era, many other statutes, such as those specifying permissible categories of investments for regulated entities, might have used such phrases as "negotiable securities" or "negotiable instruments." Section 8‑105 seems to have been included in the original version of Article 8 to avoid unfortunate interpretations of those other statutes once securities were moved from the Uniform Negotiable Instruments Law to UCC Article 8. Whether or not Section 8‑105 was necessary at that time, it has surely outlived its purpose. The statement that securities "are negotiable instruments" is very confusing. As used in the Uniform Commercial Code, the term "negotiable instrument" means an instrument that is governed by Article 3; yet Article 8 securities are not governed by Article 3. Courts have occasionally cited Section 8‑105(1) of prior law for the proposition that the rules that are generally thought of as characteristic of negotiability, such as the rule that bona fide purchasers take free from adverse claims, apply to certificated securities. Section 8‑105(1), however, is unnecessary for that purpose, since the relevant rules are set out in specific provisions of Article 8.

Prior Sections 8‑107 and 8‑314. Article 8 has never been, and should not be, a comprehensive codification of the law of contracts for the purchase and sale of securities. The prior version of Article 8 did contain, however, a number of provisions dealing with miscellaneous aspects of the law of contracts as applied to contracts for the sale of securities. Section 8‑107 dealt with one remedy for breach, and Section 8‑314 dealt with certain aspects of performance. Revised Article 8 deletes these on the theory that inclusion of a few sections on issues of contract law is likely to cause more harm than good since inferences might be drawn from the failure to cover related issues. The deletion of these sections is not, however, intended as a rejection of the rules of contract law and interpretation that they expressed.

Prior Section 8‑315. It is not entirely clear what the function of Section 8‑315 of prior law was. The section specified that the owner of a security could recover it from a person to whom it had been transferred, if the transferee did not qualify as a bona fide purchaser. It seems to have been intended only to recognize that securities, like any other form of personal property, are governed by the general principle of property law that an owner can recover property from a person to whom it has been transferred under circumstances that did not cut off the owner's claim. Although many other Articles of the UCC deal with cut‑off rules, Article 8 was the only one that included an affirmative statement of the rights of an owner to recover her property. It seems wiser to adopt the same approach as in Articles 2, 3, 7, and 9, and leave this point to other law. Accordingly, Section 8‑315 is deleted in Revised Article 8, without, of course, implying rejection of the nearly self‑evident rule that it sought to express.

Prior Section 8‑407. This section, entitled "Exchangeability of Securities," seemed to say that holders of securities had the right to cause issuers to convert them back and forth from certificated to uncertificated form. The provision, however, applied only if the issuer "regularly maintains a system for issuing the class of securities involved under which both certificated and uncertificated securities are regularly issued to the category of owners, which includes the person in whose name the new security is to be registered." The provision seems unnecessary, since it applied only if the issuer decided that it should. The matter can be covered by agreement or corporate charter or by‑laws.

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Preceding the preparation of Revised Article 8, the topic was carefully studied by the Advisory Committee on Settlement of Market Transactions of the American Bar Association Section of Business Law, under the chairmanship of Robert Haydock, Jr., of Boston, MA. Martin Aronstein, of Philadelphia, PA, reporter for the 1977 revision of Article 8, served on the Haydock Committee and continued to advise the Drafting Committee. Robert C. Mendelson, New York, NY, who also served on the Haydock Committee, is chair of the Market Transactions Advisory Committee set up by the Securities and Exchange Commission; Bob Mendelson's considerable contribution to the preparation of Revised Article 8 was most important. Other members of the Haydock Committee had continuing roles either as members of the Drafting Committee or as sources of valuable advice to that committee.

The revision of Article 8 is the culmination of a successful federal‑state collaboration among the American Law Institute and the National Conference of Commissioners on Uniform State Laws, sponsors of the Uniform Commercial Code, and representatives of the United States Department of the Treasury, the Securities and Exchange Commission, the Federal Reserve System, and other federal bodies. The product reflects the assistance of many people, and particularly of Jonathan Kallman and Ari Burstein on behalf of the SEC, Calvin Ninomiya, Cynthia E. Reese, and Virginia S. Rutledge of Treasury, Lawranne Stewart of the Board of Governors of the Federal Reserve System, Debra W. Cook and MarySue Fisher of the Federal Reserve Bank of New York, and George Wilder and Carla Behnfeldt of the Commodity Futures Trading Commission.

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PART 1.

GENERAL PROVISIONS

**SECTION 36‑8‑101.** Short title.

This chapter may be cited as Uniform Commercial Code‑‑Investment Securities.

HISTORY: 1962 Code Section 10.8‑101; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑102.** Definitions.

(a) In this chapter:

(1) "Adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer, or deal with the financial asset.

(2) "Bearer form," as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.

(3) "Broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.

(4) "Certificated security" means a security that is represented by a certificate.

(5) "Clearing corporation" means:

(i) a person that is registered as a 'clearing agency' under the federal securities laws;

(ii) a federal reserve bank; or

(iii) any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(6) "Communicate" means to:

(i) send a signed writing; or

(ii) transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(7) "Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of Section 36‑8‑501(b)(2) or (3), that person is the entitlement holder.

(8) "Entitlement order" means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(9) "Financial asset," except as otherwise provided in Section 36‑8‑103, means:

(i) a security;

(ii) an obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this chapter.

As context requires, the term means either the interest itself or the means by which a person's claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

(10) "Good faith," for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this chapter, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(11) "Indorsement" means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring, or redeeming the security or granting a power to assign, transfer, or redeem it.

(12) "Instruction" means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(13) "Registered form," as applied to a certificated security, means a form in which:

(i) the security certificate specifies a person entitled to the security; and

(ii) a transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(14) "Securities intermediary" means:

(i) a clearing corporation; or

(ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(15) "Security," except as otherwise provided in Section 36‑8‑103, means an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer:

(i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and

(iii) which:

(A) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) is a medium for investment and by its terms expressly provides that it is a security governed by this chapter.

(16) "Security certificate" means a certificate representing a security.

(17) "Security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5.

(18) "Uncertificated security" means a security that is not represented by a certificate.

(b) Other definitions applying to this chapter and the sections in which they appear are:

Appropriate person Section 36‑8‑107

Control Section 36‑8‑106

Delivery Section 36‑8‑301

Investment company security Section 36‑8‑103

Issuer Section 36‑8‑201

Overissue Section 36‑8‑210

Protected purchaser Section 36‑8‑303

Securities account Section 36‑8‑501

(c) In addition, Chapter 1 contains general definitions and principles of construction and interpretation applicable throughout this chapter.

(d) The characterization of a person, business, or transaction for purposes of this chapter does not determine the characterization of the person, business, or transaction for purposes of any other law, regulation, or rule.

HISTORY: 1962 Code Section 10.8‑102; 1966 (54) 2716; 1973 (58) 219; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑103.** Rules for determining whether certain obligations and interests are securities or financial assets.

(a) A share or similar equity interest issued by a corporation, business trust, joint stock company, or similar entity is a security.

(b) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face‑amount certificate issued by a face‑amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(c) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this chapter, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(d) A writing that is a security certificate is governed by this chapter and not by Chapter 3, even though it also meets the requirements of that chapter. However, a negotiable instrument governed by Chapter 3 is a financial asset if it is held in a securities account.

(e) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(f) A commodity contract, as defined in Section 36‑9‑102(a)(15), is not a security or a financial asset.

HISTORY: 1962 Code Section 10.8‑103; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑104.** Acquisition of security or financial asset or interest therein.

(a) A person acquires a security or an interest therein, under this chapter, if:

(1) the person is a purchaser to whom a security is delivered pursuant to Section 36‑8‑301; or

(2) the person acquires a security entitlement to the security pursuant to Section 36‑8‑501.

(b) A person acquires a financial asset, other than a security, or an interest therein, under this chapter, if the person acquires a security entitlement to the financial asset.

(c) A person who acquires a security entitlement to a security or other financial asset has the rights specified in Part 5, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in Section 36‑8‑503.

(d) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule, or agreement to transfer, deliver, present, surrender, exchange, or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (a) or (b).

HISTORY: 1962 Code Section 10.8‑104; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑105.** Notice of adverse claim.

(a) A person has notice of an adverse claim if:

(1) the person knows of the adverse claim;

(2) the person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(3) the person has a duty, imposed by statute or regulation, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(b) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(c) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(1) one year after a date set for presentment or surrender for redemption or exchange; or

(2) six months after a date set for payment of money against presentation or surrender of the certificate, if money was available for payment on that date.

(d) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(1) whether in bearer or registered form, has been indorsed 'for collection' or 'for surrender' or for some other purpose not involving transfer; or

(2) is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(e) Filing of a financing statement under Chapter 9 is not notice of an adverse claim to a financial asset.

HISTORY: 1962 Code Section 10.8‑105; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑106.** Control.

(a) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(b) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(1) the certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(2) the certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(c) A purchaser has "control" of an uncertificated security if:

(1) the uncertificated security is delivered to the purchaser; or

(2) the issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(d) A purchaser has "control" of a security entitlement if:

(1) the purchaser becomes the entitlement holder;

(2) the securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or

(3) another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(e) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(f) A purchaser who has satisfied the requirements of subsection (c) or (d) has control, even if the registered owner in the case of subsection (c) or the entitlement holder in the case of subsection (d) retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(g) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (c)(2) or (d)(2) without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

HISTORY: 1962 Code Section 10.8‑106; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑107.** Whether indorsement, instruction, or entitlement order is effective.

(a) "Appropriate person" means:

(1) with respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(2) with respect to an instruction, the registered owner of an uncertificated security;

(3) with respect to an entitlement order, the entitlement holder;

(4) if the person designated in item (1), (2), or (3) is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(5) if the person designated in item (1), (2), or (3) lacks capacity, the designated person's guardian, conservator, or other similar representative who has power under other law to transfer the security or financial asset.

(b) An indorsement, instruction, or entitlement order is effective if:

(1) it is made by the appropriate person;

(2) it is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under Section 36‑8‑106(c)(2) or (d)(2); or

(3) the appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(c) An indorsement, instruction, or entitlement order made by a representative is effective even if:

(1) the representative has failed to comply with a controlling instrument or with the law of the State having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(2) the representative's action in making the indorsement, instruction, or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(d) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction, or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(e) Effectiveness of an indorsement, instruction, or entitlement order is determined as of the date the indorsement, instruction, or entitlement order is made, and an indorsement, instruction, or entitlement order does not become ineffective by reason of any later change of circumstances.

HISTORY: 1962 Code Section 10.8‑107; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑108.** Warranties in direct holding.

(a) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:

(1) the certificate is genuine and has not been materially altered;

(2) the transferor or indorser does not know of any fact that might impair the validity of the security;

(3) there is no adverse claim to the security;

(4) the transfer does not violate any restriction on transfer;

(5) if the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(6) the transfer is otherwise effective and rightful.

(b) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that:

(1) the instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person;

(2) the security is valid;

(3) there is no adverse claim to the security; and

(4) at the time the instruction is presented to the issuer:

(i) the purchaser will be entitled to the registration of transfer;

(ii) the transfer will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction;

(iii) the transfer will not violate any restriction on transfer; and

(iv) the requested transfer will otherwise be effective and rightful.

(c) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that:

(1) the uncertificated security is valid;

(2) there is no adverse claim to the security;

(3) the transfer does not violate any restriction on transfer; and

(4) the transfer is otherwise effective and rightful.

(d) A person who indorses a security certificate warrants to the issuer that:

(1) there is no adverse claim to the security; and

(2) the indorsement is effective.

(e) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that:

(1) the instruction is effective; and

(2) at the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(f) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment, or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(g) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(h) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (g).

(i) Except as otherwise provided in subsection (g), a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (a) through (f). A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (a) or (b), and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer.

HISTORY: 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑109.** Warranties in indirect holding.

(a) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(1) the entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and

(2) there is no adverse claim to the security entitlement.

(b) A Person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in Section 36‑8‑108(a) or (b).

(c) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in Section 36‑8‑108(a) or (b).

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑110.** Applicability; choice of law.

(a) The local law of the issuer's jurisdiction, as specified in subsection (d), governs:

(1) the validity of a security;

(2) the rights and duties of the issuer with respect to registration of transfer;

(3) the effectiveness of registration of transfer by the issuer;

(4) whether the issuer owes any duties to an adverse claimant to a security; and

(5) whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(b) The local law of the securities intermediary's jurisdiction, as specified in subsection (e), governs:

(1) acquisition of a security entitlement from the securities intermediary;

(2) the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(3) whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(4) whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(c) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(d) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subsection (a)(2) through (5).

(e) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(1) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this article, or this chapter, that jurisdiction is the securities intermediary's jurisdiction.

(2) If item (1) does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(3) If neither item (1) nor item (2) applies and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(4) If none of the preceding items applies, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

(5) If none of the preceding items applies, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

(f) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑111.** Clearing corporation rules.

A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this chapter and affects another party who does not consent to the rule.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑112.** Creditor's legal process.

(a) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in subsection (d). However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(b) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (d).

(c) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in subsection (d).

(d) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(e) A creditor whose debtor is the owner of a certificated security, uncertificated security, or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑113.** Statute of frauds inapplicable.

A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

HISTORY: 1999 Act No. 42, Section 2; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑114.** Evidentiary rules concerning certificated securities.

The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑115.** Securities intermediary and others not liable to adverse claimant.

A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(2) acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) in the case of a security certificate that has been stolen, acted with notice of the adverse claim.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑116.** Securities intermediary as purchaser for value.

A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder.

HISTORY: 2001 Act No. 67, Section 5.

PART 2.

ISSUE AND ISSUER

**SECTION 36‑8‑201.** Issuer.

(a) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(1) places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation, or other interest in its property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate;

(2) creates a share, participation, or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security;

(3) directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or

(4) becomes responsible for, or in place of, another person described as an issuer in this section.

(b) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(c) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained.

HISTORY: 1962 Code Section 10.8‑201; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑202.** Issuer's responsibility and defenses; notice of defect or defense.

(a) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture, or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(b) The following rules apply if an issuer asserts that a security is not valid:

(1) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(2) Item (1) applies to an issuer that is a government or governmental subdivision, agency, or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(c) Except as otherwise provided in Section 36‑8‑205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(d) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the certificated security without notice of the particular defense.

(e) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(f) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly.

HISTORY: 1962 Code Section 10.8‑202; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑203.** Staleness as notice of defect or defense.

After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one year after that date; or

(2) is not covered by item (1) and the purchaser takes the security more than two years after the date set for surrender or presentation or the date on which performance became due.

HISTORY: 1962 Code Section 10.8‑203; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑204.** Effect of issuer's restriction on transfer.

A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) the security is certificated and the restriction is noted conspicuously on the security certificate; or

(2) the security is uncertificated and the registered owner has been notified of the restriction.

HISTORY: 1962 Code Section 10.8‑204; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑205.** Effect of unauthorized signature on security certificate.

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) an authenticating trustee, registrar, transfer agent, or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or

(2) an employee of the issuer, or of any of the persons listed in item (1), entrusted with responsible handling of the security certificate.

HISTORY: 1962 Code Section 10.8‑205; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑206.** Completion or alteration of security certificate.

(a) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(1) any person may complete it by filling in the blanks as authorized; and

(2) even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(b) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

HISTORY: 1962 Code Section 10.8‑206; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑207.** Rights and duties of issuer with respect to registered owners.

(a) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(b) This chapter does not affect the liability of the registered owner of a security for a call, assessment, or the like.

HISTORY: 1962 Code Section 10.8‑207; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑208.** Effect of signature of authenticating trustee, registrar, or transfer agent.

(a) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(1) the certificate is genuine;

(2) the person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and

(3) the person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(b) Unless otherwise agreed, a person signing under subsection (a) does not assume responsibility for the validity of the security in other respects.

HISTORY: 1962 Code Section 10.8‑208; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑209.** Issuer's lien.

A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑210.** Overissue.

(a) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(b) Except as otherwise provided in subsections (c) and (d), the provisions of this chapter which validate a security or compel its issue or reissue do not apply to the extent that validation, issue, or reissue would result in overissue.

(c) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(d) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand.

HISTORY: 2001 Act No. 67, Section 5.

PART 3.

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

**SECTION 36‑8‑301.** Delivery.

(a) Delivery of a certificated security to a purchaser occurs when:

(1) the purchaser acquires possession of the security certificate;

(2) another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or

(3) a securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(b) Delivery of an uncertificated security to a purchaser occurs when:

(1) the issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(2) another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

HISTORY: 1962 Code Section 10.8‑301; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑302.** Rights of purchaser.

(a) Except as otherwise provided in subsections (b) and (c), a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

(b) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(c) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

HISTORY: 1962 Code Section 10.8‑302; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑303.** Protected purchaser.

(a) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(1) gives value;

(2) does not have notice of any adverse claim to the security; and

(3) obtains control of the certificated or uncertificated security.

(b) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim.

HISTORY: 1962 Code Section 10.8‑303; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑304.** Indorsement.

(a) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(b) An indorsement purporting to be only of part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(c) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(d) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(e) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(f) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in Section 36‑8‑108 and not an obligation that the security will be honored by the issuer.

HISTORY: 1962 Code Section 10.8‑304; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑305.** Instruction.

(a) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(b) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by Section 36‑8‑108 and not an obligation that the security will be honored by the issuer.

HISTORY: 1962 Code Section 10.8‑305; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑306.** Effect of guaranteeing signature, indorsement, or instruction.

(a) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(3) the signer had legal capacity to sign.

(b) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(1) the signature was genuine;

(2) the signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(3) the signer had legal capacity to sign.

(c) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (b) and also warrants that at the time the instruction is presented to the issuer:

(1) the person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(2) the transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions, and claims other than those specified in the instruction.

(d) A guarantor under subsections (a) and (b) or a special guarantor under subsection (c) does not otherwise warrant the rightfulness of the transfer.

(e) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (a) and also warrants the rightfulness of the transfer in all respects.

(f) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (c) and also warrants the rightfulness of the transfer in all respects.

(g) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(h) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor.

HISTORY: 1962 Code Section 10.8‑306; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑307.** Registration of transfer of security; proof of authority to transfer.

(A) Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with other documentation necessary to obtain registration of the transfer of the security. If the transferor fails to comply with the demand within a reasonable time, the purchaser may reject or rescind the transfer.

(B) If the transfer is not for value, a transferor is not required to comply with subsection (A) unless the purchaser pays the necessary expense.

HISTORY: 2004 Act No. 221, Section 7, eff April 29, 2004.

PART 4.

REGISTRATION

**SECTION 36‑8‑401.** Duty of issuer to register transfer.

(a) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(1) under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name;

(2) the indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person;

(3) reasonable assurance is given that the indorsement or instruction is genuine and authorized under Section 36‑8‑402;

(4) any applicable law relating to the collection of taxes has been complied with;

(5) the transfer does not violate any restriction on transfer imposed by the issuer in accordance with Section 36‑8‑204;

(6) a demand that the issuer not register transfer has not become effective under Section 36‑8‑403, or the issuer has complied with Section 36‑8‑403(b) but no legal process or indemnity bond is obtained as provided in Section 36‑8‑403(d); and

(7) the transfer is in fact rightful or is to a protected purchaser.

(b) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.

HISTORY: 1962 Code Section 10.8‑401; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑402.** Assurance that indorsement or instruction is effective.

(a) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(1) in all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(2) if the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(3) if the indorsement is made or the instruction is originated by a fiduciary pursuant to Section 36‑8‑107(a)(4) or (a)(5), appropriate evidence of appointment or incumbency;

(4) if there is more than one fiduciary, reasonable assurance that all who are required to sign have done so; and

(5) if the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(b) An issuer may elect to require reasonable assurance beyond that specified in this section.

(c) In this section:

(1) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(2) "Appropriate evidence of appointment or incumbency" means:

(i) in the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within sixty days before the date of presentation for transfer; or

(ii) in any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considers appropriate.

HISTORY: 1962 Code Section 10.8‑402; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑403.** Demand that issuer not register transfer.

(a) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(b) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

(1) the certificated security has been presented for registration of transfer or the instruction for registration of transfer of the uncertificated security has been received;

(2) a demand that the issuer not register transfer had previously been received; and

(3) the issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(c) The period described in subsection (b)(3) may not exceed thirty days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(d) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either:

(1) obtain an appropriate restraining order, injunction, or other process from a court of competent jurisdiction enjoining the issuer from registering the transfer; or

(2) file with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar, or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(e) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective.

HISTORY: 1962 Code Section 10.8‑403; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑404.** Wrongful registration.

(a) Except as otherwise provided in Section 36‑8‑406, an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(1) pursuant to an ineffective indorsement or instruction;

(2) after a demand that the issuer not register transfer became effective under Section 36‑8‑403(a) and the issuer did not comply with Section 36‑8‑403(b);

(3) after the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order, or other legal process; or

(4) by an issuer acting in collusion with the wrongdoer.

(b) An issuer that is liable for wrongful registration of transfer under subsection (a) on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by Section 36‑8‑210.

(c) Except as otherwise provided in subsection (a) or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction.

HISTORY: 1962 Code Section 10.8‑404; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑405.** Replacement of lost, destroyed, or wrongfully taken security certificate.

(a) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed, or wrongfully taken, the issuer shall issue a new certificate if the owner:

(1) so requests before the issuer has notice that the certificate has been acquired by a protected purchaser;

(2) files with the issuer a sufficient indemnity bond; and

(3) satisfies other reasonable requirements imposed by the issuer.

(b) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by Section 36‑8‑210. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser.

HISTORY: 1962 Code Section 10.8‑405; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑406.** Obligation to notify issuer of lost, destroyed, or wrongfully taken security certificate.

If a security certificate has been lost, apparently destroyed, or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under Section 36‑8‑404 or a claim to a new security certificate under Section 36‑8‑405.

HISTORY: 1962 Code Section 10.8‑406; 1966 (54) 2716; 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

**SECTION 36‑8‑407.** Authenticating trustee, transfer agent, and registrar.

A person acting as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions.

HISTORY: 1991 Act No. 161, Section 1; 2001 Act No. 67, Section 5.

PART 5.

SECURITY ENTITLEMENTS

**SECTION 36‑8‑501.** Securities account; acquisition of security entitlement from securities intermediary.

(a) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(b) Except as otherwise provided in subsections (d) and (e), a person acquires a security entitlement if a securities intermediary:

(1) indicates by book entry that a financial asset has been credited to the person's securities account;

(2) receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(3) becomes obligated under other law, regulation, or rule to credit a financial asset to the person's securities account.

(c) If a condition of subsection (b) has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(d) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(e) Issuance of a security is not establishment of a security entitlement.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑502.** Assertion of adverse claim against entitlement holder.

An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who acquires a security entitlement under Section 36‑8‑501 for value and without notice of the adverse claim.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑503.** Property interest of entitlement holder in financial asset held by securities intermediary.

(a) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in Section 36‑8‑511.

(b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under Sections 36‑8‑505 through 36‑8‑508.

(d) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against a purchaser of the financial asset or interest therein only if:

(1) insolvency proceedings have been initiated by or against the securities intermediary;

(2) the securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(3) the securities intermediary violated its obligations under Section 36‑8‑504 by transferring the financial asset or interest therein to the purchaser; and

(4) the purchaser is not protected under subsection (e).

The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(e) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (a), whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under Section 36‑8‑504.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑504.** Duty of securities intermediary to maintain financial asset.

(a) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one or more other securities intermediaries.

(b) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (a).

(c) A securities intermediary satisfies the duty in subsection (a) if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(d) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑505.** Duty of securities intermediary with respect to payments and distributions.

(a) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(b) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑506.** Duty of securities intermediary to exercise rights as directed by entitlement holder.

A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑507.** Duty of securities intermediary to comply with entitlement order.

(a) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(b) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑508.** Duty of securities intermediary to change entitlement holder's position to other form of security holding.

A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) the securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or

(2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑509.** Specification of duties of securities intermediary by other statute or regulation; manner of performance of duties of securities intermediary and exercise of rights of entitlement holder.

(a) If the substance of a duty imposed upon a securities intermediary by Sections 36‑8‑504 through 36‑8‑508 is the subject of other statute, regulation, or rule, compliance with that statute, regulation, or rule satisfies the duty.

(b) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(c) The obligation of a securities intermediary to perform the duties imposed by Sections 36‑8‑504 through 36‑8‑508 is subject to:

(1) rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and

(2) rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(d) Sections 36‑8‑504 through 36‑8‑508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑510.** Rights of purchaser of security entitlement from entitlement holder.

(a) In a case not covered by the priority rules in Article 9 or the rules stated in subsection (c), an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(b) If an adverse claim could not have been asserted against an entitlement holder under Section 36‑8‑502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(c) In a case not covered by the priority rules in Chapter 9, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (d), purchasers who have control rank according to priority in time of:

(1) the purchaser's becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under Section 36‑8‑106(d)(1);

(2) the securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under Section 36‑8‑106(d)(2); or

(3) if the purchaser obtained control through another person under Section 36‑8‑106(d)(3), the time on which priority would be based under this subsection if the other person were the secured party.

(d) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

HISTORY: 2001 Act No. 67, Section 5.

**SECTION 36‑8‑511.** Priority among security interests and entitlement holders.

(a) Except as otherwise provided in subsections (b) and (c), if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(b) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(c) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders."

HISTORY: 2001 Act No. 67, Section 5.