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S.P. 430 In Senate, March 4, 1997

An Act to Amend the Uniform Commercial Code as it Relates to Letters of Credit and Investment Securities.

Reference to the Committee on Judiciary suggested and ordered printed.

JOY J. O'BRIEN
Secretary of the Senate

Presented by Senator MILLS of Somerset.

Additional copies available from Joseph W. Mayo, Clerk of the House, 2 State House Station, Augusta ME 04333 or Joy J. O'Brien, Secretary of the Senate, 3 State House Station, Augusta, ME 04333-0003. Please make check for $5.00 payable to Treasurer, State of Maine

Be it enacted by the People of the State of Maine as follows:

PART A

Sec. A-1. 11 MRSA art. 5, as amended, is repealed.

Sec. A-2. 11 MRSA art. 5-A is enacted to read:

Article 5-A

Letters of Credit

§5-1101. Short title

This Article may be known and cited as the "Uniform Commercial Code -- Letters of Credit."

Uniform Comment

The Uniform Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original Article 5 and revised Article 5 [Article 5-A] are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from

ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5 [Article 5-A], letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 [Article 5-A] is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5 [Article 5-A], but in certain circumstances they will override Article 5 [Article 5-A].

§5-1102. Definitions

(1) As used in this Article, unless the context otherwise indicates, the following terms have the following meanings.

(a) "Adviser" means a person who, at the request of the issuer, a confirmer or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed or amended.

(b) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(c) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(d) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(e) "Dishonor" of a letter of credit means failure to timely honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(f) "Document" means a written draft or other demand, document of title, investment security, certificate, invoice or other record, statement or representation of fact, law, right or opinion that:

(i) Is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in section 5-1108, subsection (5); and

(ii) Is capable of being examined for compliance with the terms and conditions of the letter of credit.

(g) "Good faith" means honesty in fact in the conduct or transaction concerned.

(h) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value and unless otherwise provided occurs:

(i) Upon payment;

(ii) If the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment; or

(iii) If the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(i) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family or household purposes.

(j) "Letter of credit" means a definite undertaking that satisfies the requirements of section 5-1104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(k) "Nominated person" means a person whom the issuer:

(i) Designates or authorizes to pay, accept, negotiate or otherwise give value under a letter of credit; and

(ii) Undertakes by agreement or custom and practice to reimburse.

(l) "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(m) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(n) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(o) "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator and receiver.

(2) Definitions in other Articles applying to this Article and the sections in which they appear are:

"Accept" or "Acceptance"	section 3-1408
"Value"	sections 3-1303, 4-211-A.

(3) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this Article.

Uniform Comment

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11) [5-1102 (l)

(k)], those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5 [Article 5-A]. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmer" for its own account or as guarantees or contracts outside of Article 5 [Article 5-A].

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation.

3. "Good faith" continues in revised Article 5 [Article 5-A] to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition -- which does not include "fair dealing" -- is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 [Article 5-A] where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U. S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair

dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and issuers with an "unfairness" defense to dishonor even when the documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer Section 5-108(d) [5-1108(4)] were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5 [Article 5-A], but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i) [5-1108(9)], 5-111,(b) [5-1111(2)], and 5-103(c) [5-1103(3)] and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-1102(a)(7) [5-1102(1)(g)] applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking" as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5 [Article 5-A], the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer

transaction, an individual cannot be an issuer where that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a) [5-1102(1)]. When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See Sections 5-102(a)(10) [5-1102(1)(j)] and 5-103(d) [5-1103(4)]. Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5 [Article 5-A]. Although Section 5-108(g) [5-1108(7)] recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10) [5-1102(1)(j)], 5-103(d) [5-1103(4)], and 5-108(g) [5-1108(7)] approve the conclusion in Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank, 493 F.2d 1285 (9th Cir. 1974).

The adjective "definite" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., Transparent Products Corp. v. Paysaver Credit Union, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit," but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are

the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) [5-1102(1)(j)] contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1) [5-1109(1)(a)].

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) [5-1102(1)(o)] will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the

"successor of a beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is "by operation of law" -- such as the sale of assets by one company to another.

11. "Draft" in Article 5 [Article 5-A] does not have the same meaning it has in Article 3 [Article 3-A]. For example, a document may be a draft under Article 5 [Article 5-A] even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e) [3-1104(5)].

§5-1103. Scope

(1) This Article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(2) The statement of a rule in this Article does not by itself require, imply or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this Article.

(3) With the exception of this subsection, subsections (1) and (4), section 5-1102, subsection (1), paragraphs (i) and (j), section 5-1106, subsection (4), and section 5-1114, subsection (4), and except to the extent prohibited in section 1-102, subsection (3) and section 5-1117, subsection (4), the effect of this Article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this Article.

(4) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

Uniform Comment

1. Sections 5-102(a)(10) [5-1102(1)(j)] and 5-103 [5-1103] are the principal limits on the scope of Article 5 [Article 5-A]. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to

describe an independent obligation like that of the issuer of a letter of credit most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks, in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This Article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 [Article 5-A] states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 [Article 5-A] is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this Article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 [Article 5-A] will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108 [5-1108], it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 [Article 5-A] and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(3) and 5-103(c) [5-1103(3)]. See Section 5-116(c) [5-1116(3)]. Normally Article 5 [Article 5-A] should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5 [Article 5-A].

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 [Article 5-A] rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 [Article 5-A] must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 [5-1108] nor that of an adviser under Section 5-107 [5-1107] is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) [5-1103(3)] and Comment 1 to Section 5-108 [5-1108] make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) [(3)] limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) [(3)] is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c) [5-1103(3)]. On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 [Article 5-A] provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only

a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102 [5-1102]. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) [5-1102(b)] and (3) [(c)] of Article 5 [Article 5-A] are omitted as unneeded; the omission does not change the law.

§5-1104. Formal requirements

A letter of credit, confirmation, advice, transfer, amendment or cancellation may be issued in any form that is a record and is authenticated by a signature or in accordance with the agreement of the parties or the standard practice referred to in section 5-1108, subsection (5).

Uniform Comment

1. Neither Section 5-104 [5-1104] nor the definition of letter of credit in Section 5-102(a)(10) [5-1102(1)(j)] requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5 [Article 5-A]. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 [5-1104] and meet the conditions specified in Section 5-102(a)(10) [5-1102(1)(j)] will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser.

An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future

developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) [5-1105] yet those undertakings are to be strictly construed (Section 5-108) [5-1108], parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 [5-1104] leaves room for future developments.

§5-1105. Consideration

Consideration is not required to issue, amend, transfer or cancel a letter of credit, advice or confirmation.

Uniform Comment

It is not to be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in Pillans v. Van Mierop, 97 Eng.Rep. 1035 (K.B. 1765) in making consideration irrelevant.

§5-1106. Issuance, amendment, cancellation and duration

(1) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to

the beneficiary. A letter of credit is revocable only if it so provides.

(2) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(3) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(4) A letter of credit that states that it is perpetual expires 5 years after its stated date of issuance or, if none is stated, after the date on which it is issued.

Uniform Comment

1. This Section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., Weyerhaeuser Co. v. First Nat. Bank, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); West Va. Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) [(2)]those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the

issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3) [5-1102(1)(c)]. When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b) [(2)]. An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108 [5-1108].

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8 [Article 8-A].

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."

§5-1107. Confirmer, nominated person and adviser

(1) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and

obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(2) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(3) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation or amendment is enforceable as issued.

(4) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment or advice has the rights and obligations of an adviser under subsection (3). The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment or advice received by the person who so notifies.

Uniform Comment

1. A confirmer has the rights and obligations identified in Section 5-108 [5-1108]. Accordingly, unless the context otherwise requires, the terms "confirmer" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) [5-1109(1)(a)(ii)]and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that

no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 [5-1109] or warranty claim under Section 5-110 [5-1110], and either might have claims against the other under Section 5-117 [5-1117].

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of Sound of Market Street v. Continental Bank International, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also

confirmed the letter of credit, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 [5-1109] that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

§5-1108. Issuer's rights and obligations

(1) Except as otherwise provided in section 5-1109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (5), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in section 5-1113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear to comply.

(2) An issuer has a reasonable time after presentation, but not beyond the end of the 7th business day of the issuer after the day of its receipt of documents:

(a) To honor;

(b) To accept a draft or incur a deferred obligation, if the letter of credit provides for honor to be completed more than 7 business days after presentation; or

(c) To give notice to the presenter of discrepancies in the presentation.

(3) Except as otherwise provided in subsection (4), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(4) Failure to give the notice specified in subsection (2) or to mention fraud, forgery or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor, fraud or forgery as described in section 5-1109, subsection (1) or expiration of the letter of credit before presentation.

(5) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(6) An issuer is not responsible for:

(a) The performance or nonperformance of the underlying contract, arrangement or transaction;

(b) An act or omission of others; or

(c) Observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (5).

(7) If an undertaking constituting a letter of credit under section 5-1102, subsection (1), paragraph (j) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(8) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(9) An issuer that has honored a presentation as permitted or required by this Article:

(a) Is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(b) Takes the documents free of claims of the beneficiary or presenter;

(c) Is precluded from asserting a right of recourse on a draft under sections 3-1414 and 3-1415;

(d) Except as otherwise provided in sections 5-1110 and 5-1117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender that are apparent on the face of the presentation; and

(e) Is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

Uniform Comment

1. This section combines some of the duties previously included in Sections 5-114 [5-1114] and 5-109 [5-1109]. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a) [5-1107(1)].

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) [5-1108(1) and (5)] and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer

will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in Banco Español de Credito v. State Street Bank and Trust Company, 385 F.2d 230 (1st Cir. 1967) and Flagship Cruises Ltd. v. New England Merchants Nat. Bank, 569 F.2d 699 (1st Cir. 1978). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in New Braunfels Nat. Bank v. Odiorne, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on 'Letter of Credit No. 86-122-5' and letter of credit specified 'Letter of Credit No. 86-122-S' holding strict compliance does not demand oppressive perfectionism). The section also indorses the result in Tosco Corp. v. Federal Deposit Insurance Corp., 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as American Coleman Co. v. Intrawest Bank, 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) [5-1108(1) or (2)] or Section 5-103(c) [5-1103(3)].

2. Section 5-108(a) [5-1108(1)] balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5 [Article 5-A], but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time would be less than seven days. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer

or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111 [5-1111], irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106 [5-1106].

The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made.

Failure of the issuer to act within the time permitted by subsection (b) [(2)] constitutes dishonor. Because of the preclusion in subsection (c) [(3)] and the liability that the issuer may incur under Section 5-111 [5-1111] for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5 [Article 5-A]. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in Flagship Cruises Ltd. v. New England Merchants' Nat. Bank, 569 F.2d 699 (1st Cir. 1978) and Wing On Bank Ltd. v. American Nat. Bank &

Trust Co., 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of Flagship and Wing On, the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as Datapoint Corp. v. M & I Bank, 665 F. Supp. 722 (W.D. Wis. 1987) and Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank, 710 F. Supp. 275 (D. Ore. 1989).

The section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b) [(2)]. Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank," or as an "acceptor" or "accepting bank," in other cases as a "negotiating bank," and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated person or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 [5-1111] as a matter of contract law. A good faith extension of the time in Section 5-108(b) [5-1108(2)] by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of Courtaulds of North America Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in Schweibish v. Pontchartrain State Bank, 389 So.2d 731 (La.App. 1980) and Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) [(5)] includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties

should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4).

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 [Article 5-A] remains aligned with the UCP (see UCP 500 Article 13c), approves cases like Pringle-Associated Mortgage Corp. v. Southern National Bank, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as Sherwood & Roberts, Inc. v. First Security Bank, 682 P.2d 149 (Mont. 1984).

Subsection (g) [(7)] recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting "shipment on vessels more than 15 years old," are to be disregarded and treated as surplusage. Similarly, a requirement that there be an award by a "duly appointed arbitrator" would not require the issuer to determine whether the arbitrator had been "duly appointed." Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 [Article 5-A] entirely. See Section 5-102(a)(10) [5-1102(1)(j)] and Comment 6 to Section 5-102 [5-1102].

Subsection (g) [(7)] would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) [(7)] is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence

of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) [(6)] condones an issuer's ignorance of "any usage of a particular trade"; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a) [5-1109(1)].

13. The last clause of Section 5-108(i)(5) [5-1108(9)(e)] deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

§5-1109. Fraud and forgery

(1) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(a) The issuer shall honor the presentation, if honor is demanded by:

(i) A nominated person who has given value in good faith and without notice of forgery or material fraud;

(ii) A confirmer who has honored its confirmation in good faith;

(iii) A holder in due course of a draft drawn under the letter of credit that was taken after acceptance by the issuer or nominated person; or

(iv) An assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(b) The issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(2) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(a) The relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(b) A beneficiary, issuer or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(c) All of the conditions to entitle a person to the relief under the law of this State have been met; and

(d) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (1), paragraph (a).

Uniform Comment

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See Cromwell v. Commerce & Energy Bank, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in

the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in Intraworld Indus. v. Girard Trust Bank, 336 A.2d 316 (Pa. 1975), Roman Ceramics Corp. v. People's Nat. Bank, 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 [5-1114] that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in Ground Air Transfer v. Westate's Airlines, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," Itek, 730 F.2d at 25 (quoting Roman Ceramics Corp. v. Peoples National Bank, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); then a court may enjoin payment.

2. Subsection (a)(2) [(1)(b)] makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section

5-114 [5-1114], that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a) [(1)]. Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in Griffin Cos. v. First Nat. Bank, 374 N.W.2d 768 (Minn.App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8) [5-1102(1)(h)]) in the particular letter of credit to occur upon acceptance and without regard to later payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance -- whether or not the acceptance constitutes honor.

5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see Ground Air Transfer Inc. v. Westates Airlines, Inc., 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) [5-1109(1)(a)] also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against -- by bond or otherwise under subsection (b)(2) [(2)(b)] -- includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

§5-1110. Warranties

(1) If its presentation is honored, the beneficiary warrants to:

(a) The issuer, any other person to whom presentation is made and the applicant that there is no fraud or forgery of the kind described in section 5-1109, subsection (1); and

(b) The applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(2) The warranties in subsection (1) are in addition to warranties arising under Articles 3-A, 4, 7 and 8-A because of the presentation or transfer of documents covered by any of those Articles.

Uniform Comment

1. Since the warranties in subsection (a) [(1)] are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by

the issuer. Any defense must be based on Section 5-108 [5-1108] or 5-109 [5-1109] and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) [(1)] cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110(a)(2) [5-1110(1)(b)] assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a) [5-1108(1)]. It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due performance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-1111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 [Article 3-A] and 4.

Unlike wrongful dishonor cases -- where the damages usually equal the amount of the draw -- the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) [(1)(b)] are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a

default of $200,000 and a draw of $500,000. The damages for breach of warranty would be no more than $300,000.

§5-1111. Remedies

(1) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation, the claimant need not present any document.

(2) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(3) If an adviser or nominated person other than a confirmer breaches an obligation under this Article or an issuer breaches an obligation not covered in subsection (1) or (2), a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (1) and (2).

(4) An issuer, nominated person or adviser who is found liable under subsection (1), (2) or (3) shall pay interest on the amount owed from the date of wrongful dishonor or other appropriate date.

(5) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this Article.

(6) Damages that would otherwise be payable by a party for breach of an obligation under this Article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

Uniform Comment

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a) [5-1111(1)], the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d) [5-1117(4)]. If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages -- at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. Doelger v. Battery Park Bank, 201 A.D. 515, 194 N.Y.S. 582 (1922)

and Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria, 497 F.Supp. 893 (S.D.N.Y. 1980), aff'd, 647 F.2d 300 (2d Cir. 1981), cert. denied, 454 U.S. 1148 (1982). The last sentence of subsection (c) [(3)] does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107 [5-1107].

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a) [5-1111(1)].

2. What damages "result" from improper honor is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) [5-1108(1)] or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at $100 per ton, but, upon delivery, the market value of conforming goods has decreased to $25 per ton. If the issuer pays over discrepancies, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $100 per ton for goods now worth $25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 [5-1117] by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c) [(3)]. The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a) [5-1111(1)]. On the other hand a confirming bank that broke its

obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c) [5-1111(3)].

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) [(5)] authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 [5-1109] or when the claimed remedy is otherwise outside of Section 5-111 [5-1111]. Neither an issuer nor a confirmer should be treated as a "losing" party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly neither should be liable for fees and expenses in that case.

"Expenses of litigation" is intended to be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) [5-1111(6)] "harm anticipated" must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504 [2A-1504].

§5-1112. Transfer of letter of credit

(1) Except as otherwise provided in section 5-1113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(2) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(a) the transfer would violate applicable law; or

(b) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer that is within the standard practice referred to in section 5-1108, subsection (5) or is otherwise reasonable under the circumstances.

Uniform Comment

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) [(1)] codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP (which make elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any

requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

"Transfer" of a letter of credit should be distinguished from "assignment of proceeds." The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant may lose

control over the identity of the person whose performance will earn payment under the letter of credit.

§5-1113. Transfer by operation of law

(1) A successor of a beneficiary may consent to amendments, sign and present documents and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(2) A successor of a beneficiary may consent to amendments, sign and present documents and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (5), an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in section 5-1108, subsection (5) or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(3) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(4) Honor of a purported successor's apparently complying presentation under subsection (1) or (2) has the consequences specified in section 5-1108, subsection (9) even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of section 5-1109.

(5) An issuer whose rights of reimbursement are not covered by subsection (4) or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (2).

(6) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

Uniform Comment

This section affirms the result in Pastor v. Nat. Republic Bank of Chicago, 76 Ill.2d 139, 390 N.E.2d 894 (Ill. 1979) and Federal Deposit Insurance Co. v. Bank of Boulder, 911 F.2d 1466 (10th Cir. 1990).

An issuer's requirements for recognition of a successor's status might include presentation of a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of a beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

§5-1114. Assignment of proceeds

(1) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(2) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(3) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(4) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(5) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(6) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a 3rd person affect the rights between the assignee and any person other than the issuer, transferee beneficiary or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary or nominated person, the rights and obligations

arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

Uniform Comment

1. Subsection (b) [(2)] expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage -- "assignment of proceeds" -- to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) [(1)] explains the meaning of "'proceeds' of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5 [Article 5-A]. Those rights and that priority are stated in subsections (c), (d), and (e) [(3), (4) and (5)]. Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds of a letter of credit, subsections (c) [(3)] and (d) [(4)] follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has been received, issuers normally have required signatures on a consent form. This practice is reflected in the

revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e) [(5)], to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) [(4)] provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

§5-1115. Statute of limitations

An action to enforce a right or obligation arising under this Article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the claim for relief or cause of action accrues, whichever occurs later. A claim for relief or cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

Uniform Comment

1. This section is based upon Sections 4-111 and 2-725(2).

2. This section applies to all claims for which there are remedies under Section 5-111 [5-1111] and to other claims made under this article, such as claims for breach of warranty under Section 5-110 [5-1110]. Because it covers all claims under Section 5-111 [5-1111], the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).

3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 [5-1115] and would not be limited by the terms of Section 5-115 [5-1115].

§5-1116. Choice of law and forum

(1) The liability of an issuer, nominated person or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in section 5-1104 or by a provision in the person's letter of credit, confirmation or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(2) Unless subsection (1) applies, the liability of an issuer, nominated person or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(3) Except as otherwise provided in this subsection, the liability of an issuer, nominated person or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation or other undertaking is expressly made subject. If this Article would govern the liability of an issuer, nominated person, or adviser under subsection (1) or (2), the relevant undertaking incorporates rules of custom or practice and there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in section 5-1103, subsection (3).

(4) If there is conflict between this Article and Article 3-A, 4, 4-A or 9, this Article governs.

(5) The forum for settling disputes arising out of an undertaking within this Article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (1).

Uniform Comment

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection

(a) [(1)] and that provided in the absence of agreement under subsection (b) [(2)] is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law -- in the absence of agreement -- even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) [(2)] states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the States of the United States renvoi will not be a problem once every jurisdiction has enacted Section 5-116 [5-1116] because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) [(2)] does not state a choice of law rule for the "liability of an applicant." However, subsection (b) [(2)] does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the "liability of an issuer, nominated person, or adviser," subsection (b) [(2)] states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a) [5-1108(1)], Comment 5 to Section 5-108 [5-1108]) and as an applicant (Section 5-107(a) [5-1107(1)], Comment 1 to Section 5-107 [5-1107], Section 5-108(i) [5-1108(9)]), subsection (b) [(2)] may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117 [5-1109, 5-1110, or 5-1117], will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 [5-1108] incorporates standard

practice, these problems should be further minimized -- at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5 [Article 5-A]. Under revised Section 5-116 [5-1116] letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 [Article 5-A] in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5 [Article 5-A]. Second, where there is no conflict between Article 5 [Article 5-A] and the relevant provision of the UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c) [5-1103(3)]. Assume, for example, that a practice provision purported to free a party from any liability unless it were "grossly negligent" or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c) [5-1103(3)].

Even though Article 5 [Article 5-A] is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5's revision, or with other practices that may develop. Rules of practice incorporated in the letter of credit or other undertaking are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 [Article 5-A] and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 [Article 5-A] conflicts with and overrides similar matters governed by Articles 3 [3-A] and 4. For example, "draft" is more broadly defined in letter of credit practice than under Section 3-104 [3-1104]. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 [3-A] and 4.

5. Subsection (e) [(5)] must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not

including letter of credit disputes, subsection (e) [(5)] does not authorize parties to choose that forum. For example, the parties' agreement under Section 5-116(e) [5-1116(5)] would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) [(5)] and if -- because of other law -- that forum will not take jurisdiction, the parties' agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for the clause will take jurisdiction -- the former in disregard of the clause and the latter in honor of the clause.

§5-1117. Subrogation of issuer, applicant and nominated person

(1) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(2) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (1).

(3) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(a) The issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(b) The beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(c) The applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(4) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (1) and (2) do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (3) do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense or excuse.

Uniform Comment

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation "were a secondary obligor." (The term "secondary obligor" refers to a surety, guarantor,, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995).) If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are "independent" of the underlying obligation. If, for example, a secondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in Tudor Development Group, Inc. v. United States Fidelity and Guaranty, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) [(4)] must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.

Sec. A-3. Savings clause. A transaction arising out of or associated with a letter of credit that was issued before the effective date of this Part and the rights, obligations and interests flowing from that transaction are governed by any statute or other law amended or repealed by this Part as if repeal or amendment had not occurred and may be terminated, completed, consummated or enforced under that statute or other law.

Sec. A-4. Applicability. This Part applies to a letter of credit that is issued on or after the effective date of this Part. This Part does not apply to a transaction, event, obligation or duty arising out of or associated with a letter of credit that was issued before the effective date of this Part.

PART B

Sec. B-1. 11 MRSA art. 8, as amended, is repealed.

Sec. B-2. 11 MRSA art. 8-A is enacted to read:

Article 8-A

Investment Securities

PART 1

SHORT TITLE AND GENERAL MATTERS

§8-1101. Short title

This Article may be known and cited as the "Uniform Commercial Code - Investment Securities."

§8-1102. Definitions

(1) As used in this Article, unless the context otherwise indicates, the following terms have the following meanings.

(a) "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.

(b) "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.

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

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

(e) "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 adoption of rules, are subject to regulation by a federal or state governmental authority.

(f) "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.

(g) "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 8-1501, subsection (2), paragraph (b) or (c), that person is the entitlement holder.

(h) "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.

(i) "Financial asset," except as otherwise provided in section 8-1103, 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 that is, or is of a type, dealt in or traded on financial markets or that 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 Article.

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.

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

(k) "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.

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

(m) "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.

(n) "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.

(o) "Security," except as otherwise provided in section 8-1103, 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) That 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) That 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) That:

(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 Article.

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

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

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

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

Appropriate person	Section 8-1107
Control	Section 8-1106
Delivery	Section 8-1301
Investment company security	Section 8-1103
Issuer	Section 8-1201
Overissue	Section 8-1210
Protected purchaser	Section 8-1303
Securities account	Section 8-1501

(3) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

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

Uniform Comment

1. "Adverse claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the secured party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as Fallon v. Wall Street Clearing Corp., 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and Pentech Intl. v. Wall St. Clearing Co., 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the

certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 [Article 3-A] negotiable instruments, from being inadvertently swept into the Article 8 [Article 8-A] definition of security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(15) [8-1102(1)(o)] probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 [Article 8-A] definition when they perform functions that would bring them within the federal securities law definition if it did not have the clause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i) [8-1108(9)], and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 [Article 8-A] rules will be sufficiently flexible to adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) as "the bargain of the parties in fact as found in their language or by

implication from other circumstances including course of dealing or usage of trade or course of performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term communicate is used in Sections 8-102(a)(8) [8-1102(1)(h)] (definition of entitlement order), 8-102(a)(12) [8-1102(1)(l)] (definition of instruction), and 8-403 [8-1403] (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 [8-1501] even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 [8-1106] and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. As noted in Comment 7, an entitlement

order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b) [8-1107(2)].

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "securities account" in Section 8-501 [8-1501], sets the scope of the indirect holding system rules of Part 5 of Revised Article 8 [Article 8-A]. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 [Article 8-A] and in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger Article 8 [Article 8-A] coverage. The indirect holding system rules of Revised Article 8 [Article 8-A] apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8 [Article 8-A]?" Rather, one must analyze whether the relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501 [8-1501]. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or

obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 [Article 8-A] for purposes of the application to Article 8 [Article 8-A] of Section 1-203, which provides that "Every contract or duty within this Act [Title] imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 [Article 8-A] is to give content to the Section 1-203 obligation as it applies to contracts and duties that are governed by Article 8 [Article 8-A]. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 [Article 8-A] have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 [8-1115] provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 [8-1404] and 8-503(e) [8-1503(5)], do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8 [Article 8-A], the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 [8-1105] on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8-308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a) [3-1204(1)]. The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized.

Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107 [8-1107].

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 [Article 8-A] securities from instruments governed by other law, such as Article 3 [Article 3-A].

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting function, while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8 [Article 8-A], regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting in the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as

a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its own account rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by Article 3 [Article 3-A]. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8 [Article 8-A].

The divisibility test of subparagraph (ii) applies to the security -- that is, the underlying intangible interest -- not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 [Article 8-A] rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that Article 8 [Article 8-A] might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or

traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is an Article 8 [Article 8-A] security. This opt-in provision allows for deliberate expansion of the scope of Article 8 [Article 8-A].

Section 8-103 [8-1103] contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8-104(c) and 8-503 [8-1104 (3) and 8-1503]. The formal definition of security entitlement set out in subsection (a)(17) [(1)(q)] of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References

"Agreement"	Section 1-201(3)
"Bank"	Section 1-201(4)

"Person"	Section 1-201(30)
"Send"	Section 1-201(38)
"Signed"	Section 1-201(39)
"Writing"	Section 1-201(46)

§8-1103. Rules for determining whether certain obligations and interests are securities or financial assets

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

(2) 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.

(3) 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 Article or it is an investment company security. An interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

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

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

(6) A commodity contract, as defined in section 9-115, is not a security or a financial asset.

Uniform Comment

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102 [8-1102]. The Section 8-102 [8-1102] definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products

that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 [8-1102] definitions to investment products not covered by this section.

2. Subsection (a) [(1)] establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded on securities exchanges or in securities markets. Thus, shares of closely held corporations are Article 8 [Article 8-A] securities.

3. Subsection (b) [(2)] establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance or redemption, rather than a transfer of shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 [8-1102] refer to "redemptions" as well as "transfers," to ensure that the Article 8 [Article 8-A] rules on such matters as signature guaranties, Section 8-306 [8-1306], assurances, Sections 8-402 and 8-507 [8-1402 and 8-1507], and effectiveness, Section 8-107 [8-1107], apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 [Article 8-A] mechanics.

4. Subsection (c) [(3)] is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) [8-1102(1)(o)(iii)] to partnership interests. Subsection (c) [(3)] establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 [Article 8-A] securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8 [Article 8-A]. Partnership interests or shares of limited liability companies are included in the broader term "financial asset." Thus, if they are held through a securities account, 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.

5. Subsection (d) [(4)] deals with the line between Article 3 [Article 3-A] negotiable instruments and Article 8 [Article 8-A] investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 [Article 8-A] definition is covered by Article 8 [Article 8-A] rather than Article 3 [Article 3-A], even though it also meets the definition of negotiable instrument. However, subsection (d) [(4)] provides that an Article 3 [Article 3-A] negotiable instrument is a "financial asset" so that the indirect holding system rules apply if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) [(5)] is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) [(6)] excludes commodity contracts from all of Article 8 [Article 8-A]. However, the Article 9 rules on security interests in investment property do apply to security interests in commodity positions. See Section 9-115 and Comment 8 thereto. "Commodity contract" is defined in Section 9-115.

Definitional Cross References

"Clearing corporation"	Section 8-102(a)(5) [8-1102(1)(e)]
"Commodity contract"	Section 9-115
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1104. Acquisition of security or financial asset or interest in a security or financial asset

(1) A person acquires a security or an interest in a security, under this Article if:

(a) The person is a purchaser to whom a security is delivered pursuant to section 8-1301; or

(b) The person acquires a security entitlement to the security pursuant to section 8-1501.

(2) A person acquires a financial asset, other than a security or an interest in a security, under this Article if the person acquires a security entitlement to the financial asset.

(3) 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 8-1503.

(4) 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 (1) or (2).

Uniform Comment

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8 [Article 8-A]. In that sense, it describes the scope of Article 8 [Article 8-A]. Subsection (a) [(1)] describes the two ways that a person may acquire a security or interest therein under this Article: (1) by delivery (Section 8-301) [8-1301], and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301 [8-1301], describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 [8-1501] on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) [(2)] specifies how a person may acquire an interest under Article 8 [Article 8-A] in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a bankers' acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3 [Article 3-A], not by Article 8 [Article 8-A]. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3 [Article 3-A], not Article 8 [Article 8-A], specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 [Article 3-A] rules specifying how negotiable instruments are transferred. The

rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 [Article 8-A] between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) [(3)] provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 [8-1503] a security entitlement is treated as a sui generis form of property interest.

3. Subsection (d) [(4)] is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8 [Article 8-A]. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) [(4)] is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or

other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d) [(4)] takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References

"Delivery"	Section 8-301 [8-1301]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Person"	Section 1-201(30)
"Purchaser"	Sections 1-201(33) and 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security entitlement"	Section 8-102(a)(17) [8-1102 (1)(q)]

§8-1105. Notice of adverse claim

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

(a) The person knows of the adverse claim;

(b) 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

(c) 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.

(2) Having knowledge that a financial asset or interest in a financial asset 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. A person who knows that a representative has transferred a financial asset or interest in a financial asset 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.

(3) 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:

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

(b) 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.

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

(a) Whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving transfer; or

(b) 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.

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

Uniform Comment

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502 and 8-510 [8-1303, 8-1502 and 8-1510], provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) -- which provides that a person has notice of a fact if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists" -- does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 [Article 8-A] in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1) [8-1102(1)(a). "Adverse claim" does not include all circumstances in which a third party has a property interest in

securities, but only those situations where a security is transferred in violation of the claimant's property interest. Therefore, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) [(2)] is a particularization of this general principle.

3. Paragraph (a)(1) [(1)(a)] provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) as actual knowledge.

4. Paragraph (a)(2) [(1)(b)] provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See May v. Chapman, 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); Goodman v. Simonds, 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) [(1)(b)] turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a non-professional.

The second prong of the willful blindness test of paragraph (a)(2) [(1)(b)] turns on whether the person "deliberately avoids information" that would establish the existence of the adverse claim. The test is the character of the person's response to the

information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) [(1)(c)] provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3) [(1)(c)]. Accordingly, the institution could not qualify as a protected purchaser under Section 8-303 [8-1303]. The same result has been reached under the prior version of Article 8. See First Nat'l Bank of Cicero v. Lewco Securities, 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) [(2)] provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser

from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See State Bank of Binghamton v. Bache, 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) [(3)] specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefore disqualified from protected purchaser status under Section 8-303 [8-1303]. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses of an issuer (Section 8-203) ([8-1203]) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a) [(1)].

8. Subsection (d) [(4)] provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d) [(4)].

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(1)]
"Bearer form"	Section 8-102(a)(2) [8-1102(1)(b)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Knowledge"	Section 1-201(25)
"Person"	Section 1-201(30)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Representative"	Section 1-201(35)
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1106. Control

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

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

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

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

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

(a) The uncertificated security is delivered to the purchaser; or

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

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

(a) The purchaser becomes the entitlement holder; or

(b) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.

(5) 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.

(6) A purchaser who has satisfied the requirements of subsection (3), paragraph (b) or subsection (4), paragraph (b) has control even if the registered owner in the case of subsection (3), paragraph (b) or the entitlement holder in the case of subsection (4), paragraph (b) 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.

(7) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (3), paragraph (b) or subsection (4), paragraph (b) 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.

Uniform Comment

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 [8-1303] (protected purchasers); 8-503(e) [8-1503(5)] (purchasers from securities intermediaries); 8-510 [8-1510] (purchasers of security entitlements from entitlement holders); 9-115(4) (perfection of security interests); 9-115(5) (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) [(1)] provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301 [8-1301]. Subsection (b) [(2)] provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301 [8-1301], provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 [8-1301] provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) [(3)] specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1) [(3)(a)], securities can be "delivered" to a purchaser. Section 8-301(b) [8-1301(2)] provides that "delivery" of an uncertificated security occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to

exercise all rights of ownership. See Section 8-207 [8-1207]. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party -- so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2) [(3)(b)], a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) [(7)] makes this point explicit. The subsection (c)(2) [(3)(b)] provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) [(4)] specifies the means by which a purchaser can obtain control over a security entitlement. Two mechanisms are possible, analogous to those provided in subsection (c) [(3)] for uncertificated securities. Under subsection (d)(1) [(4)(a)], a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary.

Subsection (d)(2) [(4)(b)] provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser, even though the transferor remains listed as the entitlement holder. This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f) [(6)].

The following examples illustrate the rules of subsection (d) [(4)]:

Example 1. Debtor grants Alpha Bank a security

interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank also has an account with Able. Debtor instructs Able to transfer the shares to Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1) [(4)(a)], because Alpha Bank is the entitlement holder.

Example 2. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha Bank does not have an account with Able. Alpha Bank uses Beta Bank as its securities custodian. Debtor instructs Able to transfer the shares to Beta Bank, for the account of Alpha Bank, and Able does so. Alpha Bank has control of the 1000 shares under subsection (d)(1) [(4)(a)], because Alpha Bank is the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha Bank enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha Bank also has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2) [(4)(b)].

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha Bank's account at Clearing Corporation. Alpha Bank has control of the 1000 shares under subsection (d)(1) [(4)(a)].

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha Bank does not have an account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta Bank's account at Clearing Corporation. Beta Bank credits the position to Alpha Bank's account with Beta Bank. Alpha Bank has control of the 1000 shares under subsection (d)(1) [(4)(a)].

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha Bank has the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2) [(4)(b)].

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. Alpha Bank has control of the 1000 shares under subsection (d)(2) [(4)(b)].

Example 8. Able & Co. a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2) [(4)(b)]. There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

5. For a purchaser to have "control" under subsection (c)(2) [(3)(b)] or (d)(2) [(4)(b)], it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) [(3)(b)] or (d)(2) [(4)(b)] because the issuer or

securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) [(3)(a)] or (d)(1) [(4)(a)] because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) [(5)] provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) [(3)(b)] or (d)(2) [(4)(b)]. Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the present ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, or to direct the disposition of the uncertificated security or security entitlement. Subsection (f) [(6)] is included to make clear the general point stated in subsection (c) [(3)] that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) [(6)] is inconsistent with the purchaser having control.

Definitional Cross References

"Bearer form"	Section 8-102(a)(2) [(8-1102(1)(b)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Delivery"	Section 8-301 [8-1301]
"Effective"	Section 8-107 [8-1107]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Entitlement order"	Section 8-102(a)(8) [8-1102(1)(h)]

"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1107. Whether indorsement, instruction or entitlement order is effective

(1) "Appropriate person" means:

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

(b) With respect to an instruction, the registered owner of an uncertificated security;

(c) With respect to an entitlement order, the entitlement holder;

(d) If the person designated in paragraph (a), (b) or (c) 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

(e) If the person designated in paragraph (a), (b), or (c) 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.

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

(a) It is made by the appropriate person;

(b) 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 8-1106, subsection (3), paragraph (b) or subsection (4), paragraph (b); or

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

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

(a) 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

(b) 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.

(4) 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.

(5) 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.

Uniform Comment

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 [Article 8-A] that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507 [8-1115 and 8-1507].

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 [8-1303] only if the purchaser obtains "control." Section 8-106 [8-1106] provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective" indorsement.

2. Subsection (a) [(1)] provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 [Article 8-A] does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) [(2)] sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 [8-1106] provide for arrangements where a person who holds securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders of instructions. Paragraph 2 [(b)] of subsection (b) [(2)] states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d) and (e) [(3), (4) and (5)] supplement the general rule of subsection (b) [(2)] on effectiveness. The term "representative," used in subsections (c) and (d) [(3) and (4)], is defined in Section 1-201(35).

4. Subsection (c) [(3)] provides that an indorsement, instruction, or entitlement order made by a representative is

effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

> Example 1. Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4) [(1)(d)]. This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 [Article 8-A] dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303 [8-1303]. Under Section 8-404 [8-1404], the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) [(4)] deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

> Example 2. Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser.

Subsection (d) [(4)] provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) [(4)] does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

> Example 3. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d) [(4)], because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306 [8-1306].

6. Subsection (e) [(5)] provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection:

> Example 4. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4) [(1)(d)]. Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404 [8-1404].

Definitional Cross References

"Entitlement order"	Section 8-102(a)(8) [8-1102(1)(h)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Representative"	Section 1-201(35)
"Securities account"	Section 8-501 [8-1501]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1108. Warranties in direct holding

(1) 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:

(a) The certificate is genuine and has not been materially altered;

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

(c) There is no adverse claim to the security;

(d) The transfer does not violate any restriction on transfer;

(e) 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

(f) The transfer is otherwise effective and rightful.

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

(a) 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;

(b) The security is valid;

(c) There is no adverse claim to the security; and

(d) 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.

(3) 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:

(a) The uncertificated security is valid;

(b) There is no adverse claim to the security;

(c) The transfer does not violate any restriction on transfer; and

(d) The transfer is otherwise effective and rightful.

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

(a) There is no adverse claim to the security; and

(b) The indorsement is effective.

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

(a) The instruction is effective; and

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

(6) 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.

(7) 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.

(8) 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 (7).

(9) Except as otherwise provided in subsection (7), a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (1) to (6). 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 (1) or (2) 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.

Uniform Comment

1. Subsections (a), (b), and (c) [(1), (2) and (3)] deal with warranties by security transferors to purchasers. Subsections (d) and (e) [(4) and (5)] deal with warranties by security transferors to issuers. Subsection (f) [(6)] deals with presentment warranties.

2. Subsection (a) [(1)] specifies the warranties made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4) and (5) [(c), (d) and (e)] make explicit several key points that are implicit in the general warranty of paragraph (6) [(f)] that the transfer is effective and rightful. Subsection (b) [(2)] sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a) [(1)], the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) [(3)] provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2) [8-1301(2)(b)]. Subsections (d) and (e) [(4) and (5)] give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) [(6)] limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in some way but to whom the

issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) [(7)] eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) [(8)] limits the warranties given by a secured party who redelivers a certificate. Subsection (i) [(9)] specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Appropriate person"	Section 8-107 [8-1107]
"Broker"	Section 8-102(a)(3) [8-1102(1)(c)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Person"	Section 1-201(30)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Secured party"	Section 9-105(1)(m)
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1109. Warranties in indirect holding

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

(a) 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

(b) There is no adverse claim to the security entitlement.

(2) 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 8-1108, subsection (1) or (2).

(3) 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 8-1108, subsection (1) or (2).

Uniform Comment

1. Subsection (a) [(1)] provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) [(2)] specifies the warranties that are given when a person who holds securities directly has the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108 [8-1108]. If the securities intermediary in turn delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) [(3)] states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i) [8-1108(9)].

3. As with the Section 8-108 [8-1108] warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3).

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Appropriate person"	Section 8-107 [8-1107]

"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Entitlement order"	Section 8-102(a)(8) [8-1102(1)(h)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Person"	Section 1-201(30)
"Securities account"	Section 8-501 [8-1501]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1110. Applicability; choice of law

(1) The local law of the issuer's jurisdiction, as specified in subsection (4), governs:

(a) The validity of a security;

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

(c) The effectiveness of registration of transfer by the issuer;

(d) Whether the issuer owes any duties to an adverse claimant to a security; and

(e) 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.

(2) The local law of the securities intermediary's jurisdiction, as specified in subsection (5), governs:

(a) Acquisition of a security entitlement from the securities intermediary;

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

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

(d) 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 in a security entitlement from an entitlement holder.

(3) 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.

(4) "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 (1), paragraphs (b) to (e).

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

(a) If an agreement between the securities intermediary and its entitlement holder specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(b) If an agreement between the securities intermediary and its entitlement holder does not specify the governing law as provided in paragraph (a) but expressly specifies that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(c) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (a) or (b), the securities intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the entitlement holder's account.

(d) If an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (a) or (b) and an account statement does not identify an office serving the entitlement holder's account as provided in paragraph (c), the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary.

(6) 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.

Uniform Comment

1. This section deals with applicability and choice of law issues concerning Article 8 [Article 8-A]. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determine the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws § 4.

2. Subsection (a) [(1)] provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 [Article 8-A] determine the issuer's rights and duties. Paragraph (1) [(a)] of subsection (a) [(1)] provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of Article 8 [Article 8-A], concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) [paragraphs (b), (c) and (d) of subsection 1] ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8 [Article 8-A], concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) [Paragraph (e) of subsection (1)] applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) [(1)] is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a) [(1)], rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) [(1)] be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) [(4)] provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) [(4)] also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1) [(a)]. The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 [8-1202] and Comments thereto.

Although subsection (a) [(1)] provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. Neither this section nor Section 1-105 deals with what law governs the appointment of the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) [(2)] provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8 [Article 8-A]. Paragraphs (1) and (2) [(a) and (b)] cover the matters dealt with in the Article 8 [Article 8-A] rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) [(c)] provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) [(d)] provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) [(5)] determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) [(2)] is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly,

subsection (e) [(5)] sets out a sequential series of tests to facilitate identification of that body of law. Paragraph (1) of subsection (e) [Paragraph (a) of subsection (5)] permits specification of the governing law by agreement. Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) [(4)] of this section and in Section 9-103(6) [9-103(7)].

Subsection (f) [(6)] makes explicit a point that is implicit in the Article 8 [Article 8-A] description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) [(3)] provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c) [(3)], New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

> Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that it is governed by Illinois law. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) [(1)] specifies that a controversy concerning the rights and duties as between the

issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) [(2) and (5)] specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in Example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed by French law. Subsection (a) [(1)] specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) [(2) and (5)] specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 [Article 8-A] does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8 [Article 8-A]. Article 8 [Article 8-A], however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115 [8-1115]. Subsection (b)(3) [(2)(c)] of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8 [Article 8-A], Section 8-115 [8-1115] as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-103(6) [9-103(7)].

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Agreement"	Section 1-201(3)
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Issuer"	Section 8-201 [8-1201]
"Person"	Section 1-201(30)
"Purchase"	Section 1-201(32)
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1111. 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 Act and affects another party who does not consent to the rule.

Uniform Comment

1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 [Article 8-A] be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509 [8-1504 to 8-1509], and Section 1-102(3) and (4). Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality

or reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 [8-1111] provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 [8-1102] covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References

"Clearing corporation" Section 8-102(a)(5) [8-1102(1)(e)]

§8-1112. Creditor's legal process

(1) 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 (4). 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.

(2) 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 (4).

(3) 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 (4).

(4) 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.

(5) 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 can not readily be reached by other legal process.

Uniform Comment

1. In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid levy cannot be made unless all possibility of the certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See Overlock v. Jerome-Portland Copper Mining Co., 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (e) [(5)] so that creditors may use this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) [(2)] provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and Shaffer v. Heitner, 433 U.S. 186 (1977).

3. Subsection (c) [(3)] provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115 [8-1115].

4. Subsection (d) [(4)] provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be

reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Issuer"	Section 8-201 [8-1201]
"Secured party"	Section 9-105(1)(m)
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1113. 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.

Uniform Comment

This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References

"Action"	Section 1-201(1)
"Contract"	Section 1-201(11)
"Writing"	Section 1-201(46)

§8-1114. Evidentiary rules concerning certificated securities

(1) The following rules apply in an action on a certificated security against the issuer.

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

(b) 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.

(c) 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.

(d) 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.

Uniform Comment

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308, to actions on certificated securities governed by this Article. An "action on a security" includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References

"Action"	Section 1-201(1)
"Burden of establishing"	Section 1-201(8)
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)
"Issuer"	Section 8-201 [8-1201]
"Presumed"	Section 1-201(31)
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1115. Securities intermediary and others not liable to adverse claimant

(1) 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:

(a) 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;

(b) Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

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

Uniform Comment

1. Other provisions of Article 8 [Article 8-A] protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502 [8-1303 and 8-1502]. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries -- the "conduits" in the indirect holding system -- and brokers or other agents or bailees -- the "conduits" in the direct holding system. The following examples illustrate its operation:

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for

exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 [8-1115] protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts § 235. See also UCC Section 7-404.

3. Except as provided in paragraph 3 [(c)], this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 [8-1115] protects Able and Baker from liability. The protections of Section 8-115 [8-1115] do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for

guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law § 134. Other sections of the UCC embody a similar policy. See Sections 3-602 [3-1601], 5-114(2)(b).

Paragraph (1) [(a)] of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) [(c)] takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen securities. Accordingly, paragraph (3) [(c)] denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105 [8-1105]. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 [Article 8-A] indirect holding system rules -- that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

> Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115 [8-1115], Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.
>
> Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115 [8-1115], Clearing Corporation is not liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) [(b)] provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determine whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts § 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 [Article 8-A] deals with is the clerical or ministerial role of implementing and recording the securities

transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References

"Broker"	Section 8-102(a)(3) [8-1102(1)(c)]
"Effective"	Section 8-107 [8-1107]
"Entitlement order"	Section 8-102(a)(8) [8-1102(1)(h)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1116. 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.

Uniform Comment

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section 1-201(44)(d) should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section:

Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 [8-1116] specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303 [8-1303], which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501 [8-1501]. Section 8-116 [8-1116] specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502 [8-1502], which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 [8-1116] specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303 [8-1303], which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References

"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]

PART 2

ISSUE AND ISSUER

§8-1201. Issuer

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

(a) 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;

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

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

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

(2) 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.

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

Uniform Comment

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part 2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15) [8-1102(1)(o)].

2. Subsection (b) [(2)] distinguishes the obligations of a guarantor as issuer from those of the principal obligor.

However, it does not exempt the guarantor from the impact of subsection (d) [(4)] of Section 8-202 [8-1202]. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) [(3)] narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407 [8-1407].

Definitional Cross References

"Person"	Section 1-201(30)
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1202. Issuer's responsibility and defenses; notice of defect or defense

(1) 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.

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

(a) 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.

(b) Paragraph (a) 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.

(3) Except as otherwise provided in Section 8-1205, lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(4) 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.

(5) 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.

(6) 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.

Uniform Comment

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) [(1)] states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate

reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. Delaware-New Jersey Ferry Co. v. Leeds, 21 Del.Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. Bonini v. Family Theatre Corporation, 327 Pa. 273, 194 A. 498 (1937); First National Bank of Fairbanks v. Alaska Airmotive, 119 F.2d 267 (C.C.A.Alaska 1941).

2. The rule in subsection (a) [(1)] requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) [(1)] is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) [(1)] concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) [(1)] is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) [(1)] applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) [(1)] does not apply.

3. The penultimate sentence of subsection (a) [(1)] and all of subsection (b) [(2)] embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) [(1)] makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) [(2)] gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: first, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) [(2)] from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as Tommie v. City of Gadsden, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. Chaffee County v. Potter, 142 U.S. 355 (1892); Oregon v. Jennings, 119 U.S. 74 (1886); Gunnison County Commissioners v. Rollins, 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. Anthony v. County of Jasper, 101 U.S. 693 (1879); Town of South Ottawa v. Perkins, 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210 [8-1210], regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) [(5)] is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) [(6)] has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for value without notice. Section 8-202 [8-1202] describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) [(6)]

is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Notice"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1203. 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 subsection (1) and the purchaser takes the security more than 2 years after the date set for surrender or presentation or the date on which performance became due.

Uniform Comment

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is

effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 [8-1105] and Comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Notice"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1204. 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.

Uniform Comment

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401 [8-1401].

3. The policy of this section is the same as in Section 8-202 [8-1202]. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii) [8-1108(2)(d)(iii)]. B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the

books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) [8-1202(1)] and Comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See Quiner v. Marblehead Social Co., 10 Mass. 476 (1813); Madison Bank v. Price, 79 Kan. 289, 100 P. 280 (1909); Healey v. Steele Center Creamery Ass'n, 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Conspicuous"	Section 1-201(10)
"Issuer"	Section 8-201 [8-1201]
"Knowledge"	Section 1-201(25)
"Notify"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1205. 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 subsection (1), entrusted with responsible handling of the security certificate.

Uniform Comment

1. The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co., 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am.St.Rep. 712 (1893); Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however, is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. Citizens' & Southern National Bank v. Trust Co. of Georgia, 50 Ga.App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as Hudson Trust Co. v. American Linseed Co., 232 N.Y. 350, 134 N.E. 178 (1922), and Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co., 213 Pa. 307, 62 A. 916, 5 Ann.Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Issuer"	Section 8-201 [8-1201]
"Notice"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Unauthorized signature"	Section 1-201(43)

§8-1206. Completion or alteration of security certificate

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

(a) Any person may complete it by filling in the blanks as authorized; and

(b) 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.

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

Uniform Comment

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a) [8-1305(1)]).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the

original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a) [8-1302(1)].

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210 [8-1210]).

Definitional Cross References

"Notice"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Unauthorized signature"	Section 1-201(43)
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1207. Rights and duties of issuer with respect to registered owners

(1) 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.

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

Uniform Comment

1. Subsection (a) [(1)] states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401 [8-1401]. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsection (a) [(1)] is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. Barbato v. Breeze Corporation, 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See State ex rel. Squire v. Murfey, Blosson & Co., 131 Ohio St. 289, 2 N.E.2d 866 (1936); Willing v. Delaplaine, 23 F.Supp. 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1208. Effect of signature of authenticating trustee, registrar or transfer agent

(1) 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:

(a) The certificate is genuine;

(b) 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

(c) 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.

(2) Unless otherwise agreed, a person signing under subsection (1) does not assume responsibility for the validity of the security in other respects.

Uniform Comment

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See Jarvis v. Manhattan Beach Co., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am.St.Rep. 727 (1896). Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit in terms of due care. See Feldmeier v. Mortgage Securities, Inc., 34 Cal.App.2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. Ainsa v. Mercantile Trust Co., 174 Cal. 504, 163 P. 898 (1917); Tschetinian v. City Trust Co., 186 N.Y. 432, 79 N.E. 401 (1906); Davidge v. Guardian Trust Co. of New York, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act (U.S.C.A., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. Jarvis v. Manhattan Beach Co., supra; Mullen v. Eastern Trust & Banking Co., 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205 [8-1205].

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Genuine"	Section 1-201(18)
"Issuer"	Section 8-201 [8-1201]
"Notice"	Section 1-201(25)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1209. 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.

Uniform Comment

This section is similar to Sections 8-202 and 8-204 [8-1202 and 8-1204] which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement in haec verba. This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204 [8-1202 and 8-1204], see Comment 2 to Section 8-202 [8-1202].

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Issuer"	Section 8-201 [8-1201]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1210. Overissue

(1) 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.

(2) Except as otherwise provided in subsections (3) and (4), the provisions of this Article 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.

(3) 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.

(4) 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.

Uniform Comment

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, McWilliams v. Geddes & Moss Undertaking Co., 169 So. 894 (1936, La.); Crawford v. Twin City Oil Co., 216 Ala. 216, 113 So. 61 (1927); New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d) [(3) and (4)]. The last clause of subsection (a) [(1)], which is added in Revised Article 8 [Article 8-A], does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. West v. Tintic Standard Mining Co., 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. New York and New Haven R.R. Co. v. Schuyler, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. Allen v. South Boston Railroad, 150 Mass. 200, 22 N.E.

917, 5 L.R.A. 716, 15 Am.St.Rep. 185 (1889); Commercial Bank v. Kortright, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References

"Issuer"	Section 8-201 [8-1201]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

PART 3

TRANSFER OF CERTIFICATED AND UNCERTIFICATED SECURITIES

§8-1301. Delivery

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

(a) The purchaser acquires possession of the security certificate;

(b) 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

(c) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and has been specially indorsed to the purchaser by an effective indorsement.

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

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

(b) 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.

Uniform Comment

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 [Article 8-A] to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transaction, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) [(1)] defines delivery with respect to certificated securities. Paragraph (1) [(a)] deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) [Paragraphs (b) and (c) of subsection (1)] specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) [(b)] contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) [(b)] does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501[8-1501]. Subsection (a)(3) [(1)(c)] specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer.

3. Subsection (b) [(2)] defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called "delivery," as in the expression "delivery versus payment." The diction of this section has the advantage of using the same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) [Paragraph (a) of subsection (2)] provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) [(b)] provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2) [(1)(b)].

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Effective"	Section 8-107 [8-1107]
"Issuer"	Section 8-201 [8-1201]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Special indorsement"	Section 8-304(a) [8-1304(1)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1302. Rights of purchaser

(1) Except as otherwise provided in subsections (2) and (3), upon delivery of a certificated or uncertificated security to a purchaser, the purchaser acquires all rights in the security that the transferor had or had power to transfer.

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

(3) 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.

Uniform Comment

1. Subsection (a) [(1)] provides that if a certificated or uncertificated security is delivered (Section 8-301 [8-1301]) to a purchaser in a transfer, the purchaser acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b) [(2)], and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c) [(3)].

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security upon "delivery," it does not state that a person can acquire an interest in a security only by delivery. Article 8 [Article 8-A] is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8

[Article 8-A]. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 [Article 8-A] delivery, but need not be.

Similarly, Article 8 [Article 8-A] does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 [Article 8-A] deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 [Article 8-A] rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404 [8-1207, 8-1401 and 8-1404].

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Notice of adverse claim"	Section 8-105 [8-1105]
"Protected purchaser"	Section 8-303 [8-1303]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]
"Delivery"	Section 8-301 [8-1301]

§8-1303. Protected purchaser

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

(a) Gives value;

(b) Does not have notice of any adverse claim to the security; and

(c) Obtains control of the certificated or uncertificated security.

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

Uniform Comment

1. Subsection (a) [(1)] lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) [(2)] provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in Section 1-201. A secured party as well as an outright buyer can qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44). See also Section 8-116 [8-1116] (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1) [8-1102(1)(a)]. Section 8-105 [8-1105] specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106 [8-1106]. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d) [8-1304(4)].

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202 [8-1202].

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a) [8-1106(1) and 8-1301(1)]. For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b) [8-1301(2)], plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b) [8-1106(2)]. Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404 [8-1404], unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406 [8-1406].

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b) [8-1106(3)(a) and 8-1301(2)], or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2) [8-1106(3)(b)]. The control agreement device of Section 8-106(c)(2) [8-1106(3)(b)] takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) [8-1106(3)(b)] can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 [8-1105] on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Control"	Section 8-106 [8-1106]
"Notice of adverse claim"	Section 8-105 [8-1105]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1304. Indorsement

(1) 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.

(2) 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.

(3) 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.

(4) 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.

(5) 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.

(6) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in section 8-1108 and not an obligation that the security will be honored by the issuer.

Uniform Comment

1. By virtue of the definition of indorsement in Section 8-102 [8-1102] and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) [(2)] recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) [(3)] deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. Levey v. Nason, 279 Mass. 268, 181 N.E. 193 (1932), and National Surety Co. v.

Indemnity Insurance Co. of North America, 237 App.Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and this Article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection (d) [(4)] on right to compel indorsement, such as is envisaged in Johnson v. Johnson, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) [(4)] deals with the effect of delivery without indorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202 [8-1202]).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See Coats v. Guaranty Bank & Trust Co., 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307 [8-1307]). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) [(5)] deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d) [8-1105(4)]) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) [(6)] makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment

securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108 [8-1108]).

Definitional Cross References

"Bearer form"	Section 8-102(a)(2) [8-1102(1)(b)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1305. Instruction

(1) 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.

(2) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed by section 8-1108 and not an obligation that the security will be honored by the issuer.

Uniform Comment

1. The term instruction is defined in Section 8-102(a)(12) [8-1102(1)(1)] as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 [8-1107] specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6) [8-1102(1)(f)]. Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) [(1)] gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had

authority to complete it. Compare Section 8-206 [8-1206] and its Comment, dealing with blanks left upon issue.

2. Subsection (b) [(2)] makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108 [8-1108].

Definitional Cross References

"Appropriate person"	Section 8-107 [8-1107]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(1)]
"Issuer"	Section 8-201 [8-1201]

§8-1306. Effect of guaranteeing signature, indorsement or instruction

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

(a) The signature was genuine;

(b) 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

(c) The signer had legal capacity to sign.

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

(a) The signature was genuine;

(b) 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

(c) The signer had legal capacity to sign.

(3) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (2) and also warrants that at the time the instruction is presented to the issuer:

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

(b) 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.

(4) A guarantor under subsections (1) and (2) or a special guarantor under subsection (3) does not otherwise warrant the rightfulness of the transfer.

(5) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (1) and also warrants the rightfulness of the transfer in all respects.

(6) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (3) and also warrants the rightfulness of the transfer in all respects.

(7) 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.

(8) 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.

Uniform Comment

1. Subsection (a) [(1)] provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) [(2)] provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) [8-1107(1)] to include a successor or person who has power under other law to act for a person who is deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is

indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) [8-1107(1)] does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) [8-1107(2)] if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co., 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) [(2)] sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) [(b)] of subsection (b) [(2)] is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under paragraph (2) [(b)], warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) [(3)] sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (c) [(3)], the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) [(4)] makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) [(5) and (6)] provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) [(7)] makes clear what can be inferred from the combination of Sections 8-401 and 8-402 [8-1401 and 8-1402], that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) [(8)] specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References

"Appropriate person"	Section 8-107 [8-1107]
"Genuine"	Section 1-201(18)
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1307. Purchaser's right to requisites for registration of transfer

Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but, if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer.

Uniform Comment

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare Section 8-304(d) [8-1304(4)]. If a transfer is not for value the transferor need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional Cross References

"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

PART 4

REGISTRATION

§8-1401. Duty of issuer to register transfer

(1) 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:

(a) Under the terms of the security, the person seeking registration of transfer is eligible to have the security registered in its name;

(b) 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;

(c) Reasonable assurance is given that the indorsement or instruction is genuine and authorized in accordance with section 8-1402;

(d) Any applicable law relating to the collection of taxes has been complied with;

(e) The transfer does not violate any restriction on transfer imposed by the issuer in accordance with section 8-1204;

(f) A demand that the issuer not register transfer has not become effective under section 8-1403, or the issuer has complied with section 8-1403, subsection (2) but no legal process or indemnity bond is obtained as provided in section 8-1403, subsection (4); and

(g) The transfer is in fact rightful or is to a protected purchaser.

(2) 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.

Uniform Comment

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist.

If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3) [(1)(c)]. If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404 [8-1404].

2. By subsection (b) [(2)] the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) [8-1201(3)] provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this Part similar to those of the issuer. See Section 8-407 [8-1407].

Definitional Cross References

"Appropriate person"	Section 8-107 [8-1107]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Genuine"	Section 1-201(18)
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Protected purchaser"	Section 8-303 [8-1303]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1402. Assurance that indorsement or instruction is effective

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

(a) 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;

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

(c) If the indorsement is made or the instruction is originated by a fiduciary pursuant to section 8-1107, subsection (1), paragraph (d) or (e), appropriate evidence of appointment or incumbency;

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

(e) 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.

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

(3) In this section:

(a) "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; and

(b) "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 of the court and dated within 60 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.

Uniform Comment

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404 [8-1404]. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) [(2)] provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b) [8-1401(2)].

2. Under subsection (a)(1) [(1)(a)], the issuer may require in all cases a guaranty of signature. See Section 8-306 [8-1306]. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) [(3)] allows the issuer to require that the person making these guaranties be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 CFR 240.17Ad-15.

3. This section, by paragraphs (2) through (5) [(b) to (e)] of subsection (a) [(1)], permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306 [8-1306]. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," etc. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c) [8-1107(3)]. Hence court orders and other controlling instruments are omitted from subsection (a) [(1)].

Subsection (a)(3) [(1)(c)] authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) [(3)] indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified

by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i) [(3)(b)(i)]. Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) [(3)(b)(ii)] applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d) [8-1107(4)], hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) [(2)] to require assurance beyond that specified in subsection (a) [(1)]. On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404 [8-1404].

Definitional Cross References

"Appropriate person"	Section 8-107 [8-1107]
"Genuine"	Section 1-201(18)
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]

§8-1403. Demand that issuer not register transfer

(1) 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.

(2) 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 the person who initiated the demand at the address provided in the demand and the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that:

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

(b) A demand that the issuer not register transfer had previously been received; and

(c) 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.

(3) The period described in subsection (2), paragraph (c) may not exceed 30 days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(4) 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:

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

(b) 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.

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

Uniform Comment

1. The general rule under this Article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process

merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404 [8-1404]. Section 8-403 [8-1403] is an exception to this general rule. It permits the registered owner -- but not third parties -- to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See Section 8-406 [8-1406]. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405 [8-1405]. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) [(5)] makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406 [8-1107(2) and 8-1406], might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References

"Appropriate person"	Section 8-107 [8-1107]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Communicate"	Section 8-102(a)(6) [8-1102(1)(f)]
"Effective"	Section 8-107 [8-1107]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1404. Wrongful registration

(1) Except as otherwise provided in section 8-1406, 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:

(a) Pursuant to an ineffective indorsement or instruction;

(b) After a demand that the issuer not register transfer became effective under section 8-1403, subsection (1) and the issuer did not comply with section 8-1403, subsection (2);

(c) 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

(d) By an issuer acting in collusion with the wrongdoer.

(2) An issuer that is liable for wrongful registration of transfer under subsection (1) 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 8-1210.

(3) Except as otherwise provided in subsection (1) 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.

Uniform Comment

1. Subsection (a)(1) [(1)(a)] provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 [8-1402] does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) [(2)] specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. Casper v. Kalt-Zimmers Mfg. Co., 159 Wis. 517, 149 N.W. 754 (1914). Article 8 [Article 8-A] does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210 [8-1210]. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (c) and (a) [(3) and (1)] have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 [8-1115] applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an

effective indorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 [8-1403] (1978).

The rule of former Section 8-403 was anomalous inasmuch as Section 8-207 [8-1207] provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207 [8-1207], the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See Kerrigan v. American Orthodontics Corp., 960 F.2d 43 (7th Cir. 1992). The change made in the present version of Section 8-404 [8-1404] ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Effective"	Section 8-107 [8-1107]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Instruction"	Section 8-102(a)(12) [8-1102(1)(l)]
"Issuer"	Section 8-201 [8-1201]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§8-1405. Replacement of lost, destroyed or wrongfully taken security certificate

(1) 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:

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

(b) Files with the issuer a sufficient indemnity bond; and

(c) Satisfies other reasonable requirements imposed by the issuer.

(2) 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 8-1210. 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.

Uniform Comment

1. This section enables the owner to obtain a replacement of a lost, destroyed or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an "original" security certificate has reached the hands of a protected purchaser, the registered owner -- who was in the best position to prevent the loss, destruction or theft of the security certificate -- is now deprived of the new security certificate issued as a replacement. This changes the pre-UCC law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. Keller v. Eureka Brick Mach. Mfg. Co., 43 Mo.App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210 [8-1210]. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References

"Bearer form"	Section 8-102(a)(2) [8-1102(1)(b)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Issuer"	Section 8-201 [8-1201]
"Notice"	Section 1-201(25)
"Overissue"	Section 8-210 [8-1210]
"Protected purchaser"	Section 8-303 [8-1303]
"Registered form"	Section 8-102(a)(13) [8-1102(1)(m)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1406. 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 8-1404 or a claim to a new security certificate under Section 8-1405.

Uniform Comment

An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404 [8-1404], unless the owner made an effective demand that the issuer not register transfer under Section 8-403 [8-1403].

Definitional Cross References

"Issuer"	Section 8-201 [8-1201]
"Notify"	Section 1-201(25)
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]

§8-1407. 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.

Uniform Comment

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere non-feasance, i.e., refusal to register a transfer, are rejected. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944); Nicholson v. Morgan, 119 Misc. 309, 196 N.Y.Supp. 147 (1922); Lewis v. Hargadine-McKittrick Dry Goods Co., 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405 [8-1405], which makes express provision for the issue of substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co., 152 App.Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Issuer"	Section 8-201 [8-1201]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

PART 5

SECURITY ENTITLEMENTS

§8-1501. Securities account; acquisition of security entitlement from securities intermediary

(1) "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.

(2) Except as otherwise provided in subsections (4) and (5), a person acquires a security entitlement if a securities intermediary:

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

(b) 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

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

(3) If a condition of subsection (2) has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(4) 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.

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

Uniform Comment

1. Part 5 rules apply to security entitlements, and Section 8-501(b) [8-1501(2)] provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3). There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102, however, states the fundamental principle of interpretation that the Code provisions should be construed and

applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 [Article 8-A] to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5, which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 [Article 8-A] concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 [Article 8-A] if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) [(2)] of this section specifies what circumstances give rise to security entitlements. Paragraph (1) [(a)] of subsection (b) [(2)] sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) [(a)] does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing

accounting and information processing systems. The point of paragraph (1) [(a)] is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) [(b)] of subsection (b) [(2)] sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) [(2)(b)] a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) [(2)(b)] also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) [(2)(b)] is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) [(2)(b)] also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) [(2)(b)] provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) [(b)] will also be covered by paragraph (1) [(a)], because the intermediary will have credited the positions to the customer's account.

Paragraph (3) [(c)] of subsection (b) [(2)] sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer

from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) [(b)] test, the paragraph (3) [(c)] test would not be needed for the ordinary cases, since they are covered by paragraph (1) [(a)].

3. In a sense, Section 8-501(b) [8-1501(2)] is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8 [Article 8-A], however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) [(3)] is intended to make this point clear. Subsection (c) [(3)] does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 [8-1504] and regulatory law. Subsection (c) [(3)] is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 [Article 8-A] sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) [(4)] specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) [(4)] corresponds to the rule set out in Section 8-301(a)(3) [8-1301(1)(c)] specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) [(5)] is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. 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. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15) [8-1102(1)(o)]. If so, then by virtue of subsection (e) [(5)] of Section 8-501 [8-1501], the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 [Article 8-A] rather than establishment of a security entitlement to the underlying securities.

The subsection (e) [(5)] rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement. Among the key components of

the definition of security in Section 8-102(a)(15) [8-1102(1)(o)] are the "transferability" and "divisibility" tests. Securities, in the Article 8 [Article 8-A] sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References

"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Indorsement"	Section 8-102(a)(11) [8-1102(1)(k)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1502. 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 8-1501 for value and without notice of the adverse claim.

Uniform Comment

1. The section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 [8-1501] for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims (Section 8-303 [8-1303]).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503 [8-1503]. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 [8-1501] for value and without notice of adverse claims takes "that security entitlement" free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant's rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S's identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover "her shares." Even if S can show that, at the stage of the trade, her sell order was matched with B's buy order, that would not suffice to show that "her shares" went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able's net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S's account to B's account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B's security entitlement is not the same item of property that

formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501 [8-1501]. Principles of equitable remedies might, however, provide S with a basis for contending that if the position B received was the traceable product of the wrongful taking of S's property by S's twin, a constructive trust should be imposed on B's property in favor of S. See G. Palmer, The Law of Restitution § 2.14. Section 8-502 [8-1502] ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 [8-1501] for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See Section 8-507(b) [8-1507(2)].

3. The following examples illustrate the operation of Section 8-502 [8-1502].

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b) [8-1501(2)]. Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was himself the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 [8-1502] does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b) [8-1501(2)]. Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44). If Creditor did not have notice of Owner's claim, Section 8-502 [8-1502] precludes

any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 [8-1105] specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties, Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume -- implausibly -- that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 [8-1502] precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-115. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume -- implausibly -- that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 [8-1502] precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501 [8-1501]. Lending Bank acquired the security

entitlement for value, since it acquired it as security for a debt. See Section 1-201(44). If Lending Bank did not have notice of Acme's claim, Section 8-502 [8-1502] will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b) [8-1503(2)]. Section 8-502 [8-1502] protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 [8-1502] plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Notice of adverse claim"	Section 8-105 [8-1105]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1503. Property interest of entitlement holder in financial asset held by securities intermediary

(1) 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 8-1511.

(2) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) 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.

(3) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under sections 8-1505 to 8-1508.

(4) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) may be enforced against a purchaser of the financial asset or interest in the financial asset only if:

(a) Insolvency proceedings have been initiated by or against the securities intermediary;

(b) 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;

(c) The securities intermediary violated its obligations under section 8-1504 by transferring the financial asset or interest in the financial asset to the purchaser; and

(d) The purchaser is not protected under subsection (5). 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 in the financial asset, 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.

(5) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (1), 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 in a financial asset who gives value, obtains control and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under section 8-1504.

Uniform Comment

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) [(1)] provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held for the entitlement holders, are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511 [8-1511].

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) [(2)] makes clear that the property interest described in subsection (a) [(1)] is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it

does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8 [Article 8-A], not by common law property concepts. The traditional Article 8 [Article 8-A] rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 [Article 8-A] rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances

where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) [(3) to (5)] reflect these fundamental principles.

Subsection (c) [(3)] provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508 [8-1505 to 8-1508]. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) [(4) and (5)] specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection (d) [(4)] provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504 [8-1504]. Thus, paragraphs (1), (2), and (3) [(a), (b) and (c)] of subsection (d) [(4)] specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e) [(5)], unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) [(4) and (5)] have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) [(4) and (5)] specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 [Article 8-A] also contains general adverse claim cut-off rules for the indirect holding system. See Sections

8-502 and 8-510 [8-1502 and 8-1510]. The rule of subsections (d) and (e) [(4) and (5)] takes precedence over the general cut-off rules of those sections, because Section 8-503 [8-1503] itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e) [8-1503(5)], rather than by the "without notice" test of Sections 8-502 and 8-510 [8-1502 and 8-1510].

3. The limitations that subsections (c) through (e) [(3) to (5)] place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this Article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in which no wrongful conduct occurred or will occur, rather than from the post hoc perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) [8-1503(5)] furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) [8-1503(5)] is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 [Article 8-A] concerning transfers by fiduciaries provide a good example. Under Lowry v. Commercial & Farmers' Bank, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the Lowry rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8 [Article 8-A], and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 [Article 8-A] implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities

intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) [8-1503(3) to (5)] apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511 [8-1511]. The statement in subsection (a) [(1)] that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the debtor must have "rights" in the collateral, see Section 9-203, the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511 [8-1511], which is an application to secured transactions of the general principles expressed in subsections (d) and (e) [(4) and (5)] of this section.

Definitional Cross References

"Control"	Section 8-106 [8-1106]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Insolvency proceedings"	Section 1-201(22)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1504. Duty of securities intermediary to maintain financial asset

(1) 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.

(2) 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 (1).

(3) A securities intermediary satisfies the duty in subsection (1) if:

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

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

(4) 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.

Uniform Comment

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. § 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) [(1)] provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) [8-1102(1)(i)] provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) [(2)] states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is

wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom a securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511 [8-1503 and 8-1511].

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 [8-1504 to 8-1508] contains an "agreement/due care" provision. Second, Section 8-509 [8-1509] sets out general qualifications on the duties stated in these sections, including

the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 [Article 8-A] duties.

4. The "agreement/due care" provision in subsection (c) [(3)] of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) [(1)] to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) [(3)(a)] provides that a securities intermediary satisfies the duty stated in subsection (a) [(1)] if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) [(3)(b)] provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) [(1)] duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1) [(3)(a)], compliance with the agreement constitutes satisfaction of the subsection (a) [(1)] duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and

performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10) [8-1102(1)(j)], would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) [(3)(a)] has specified the details of the intermediary's performance of the subsection (a) [(1)] duty, subsection (c)(2) [(3)(b)] provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safeguarding of customer securities. See 17 C.F.R. § 240.15c3-3. Section 8-509(a) [8-1509(1)] provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-504 [8-1504]. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) [(4)] is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e) [8-1103(5)]. Accordingly, the general duty of an intermediary under subsection (a) [(1)] does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508 [8-1503 and 8-1508].

Definitional Cross References

"Agreement"	Section 1-201(3)
"Clearing corporation"	Section 8-102(a)(5) [8-1102(1)(e)]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1505. Duty of securities intermediary with respect to payments and distributions

(1) 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:

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

(b) 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.

(2) 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.

Uniform Comment

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that

the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) [(1)] expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) [(1)] incorporates the same "agreement/due care" formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504 [8-1504]. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 [8-1509] also apply to the Section 8-505 [8-1505] duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 [8-1505] duty.

3. Subsection (b) [(2)] provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) [8-1509(3)] makes this point explicit.

Definitional Cross References

"Agreement"	Section 1-201(3)
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1506. 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.

Uniform Comment

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care" formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer

discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 [8-1509] also applies to the Section 8-506 [8-1506] duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a) [8-1509(1)], compliance with such regulatory requirement constitutes compliance with the Section 8-506 [8-1506] duty.

Definitional Cross References

"Agreement"	Section 1-201(3)
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1507. Duty of securities intermediary to comply with entitlement order

(1) 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:

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

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

(2) 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.

Uniform Comment

1. Subsection (a) [(1)] of this section states another aspect of duties of securities intermediaries that make up security entitlements -- the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) [(2)] states the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 [8-1509] apply to the Section 8-507 [8-1507] duty.

3. Appropriate person is defined in Section 8-107 [8-1107]. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3) [8-1107(1)(c)]. Entitlement holder is defined in Section 8-102(a)(7) [8-1102(1)(g)] as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115 [8-1115]. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5) [8-1107(1)(d) and (1)(e)], which provide that the term "appropriate person" includes the

successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106 [8-1106]. Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) [(1)] duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b) [8-1107(1) and (2)]. Moreover, Section 8-507(a) [8-1507(1)] provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) [(2)] provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 [8-1107] specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) [8-1107(2)] if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b) [(2)], together with Section 8-107 [8-1107], has the effect of leaving to other law most of the questions of

the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 [Article 8-A] is not a codification of all of the law of customers and stockbrokers. Article 8 [Article 8-A] deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this Article.

Definitional Cross References

"Agreement"	Section 1-201(3)
"Appropriate person"	Section 8-107 [8-1107]
"Effective"	Section 8-107 [8-1107]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Entitlement order"	Section 8-102(a)(8) [8-1102(1)(h)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1508. 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.

Uniform Comment

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements -- the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in blank or specially indorsed to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 [(8-1509] apply to the Section 8-508 [8-1508] duty.

Definitional Cross References

"Agreement"	Section 1-201(3)
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]

§8-1509. 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

(1) If the substance of a duty imposed upon a securities intermediary by sections 8-1504 to 8-1508 is the subject of other statute, regulation or rule, compliance with that statute, regulation or rule satisfies the duty.

(2) 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.

(3) The obligation of a securities intermediary to perform the duties imposed by sections 8-1504 to 8-1508 is subject to:

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

(b) 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.

(4) Sections 8-1504 to 8-1508 do not require a securities intermediary to take any action that is prohibited by other statute, regulation or rule.

Uniform Comment

This Article is not a comprehensive statement 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. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 [8-1504 to 8-1508] specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) [(1)] provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508 [8-1504 to 8-1508].

Definitional Cross References

"Agreement"	Section 1-201(3)
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security agreement"	Section 9-105(1)(1)
"Security interest"	Section 1-201(37)

§8-1510. Rights of purchaser of security entitlement from entitlement holder

(1) 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 in a security entitlement from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim and obtains control.

(2) If an adverse claim could not have been asserted against an entitlement holder under section 8-1502, the adverse claim can not be asserted against a person who purchases a security entitlement or an interest in a security entitlement from the entitlement holder.

(3) In a case not covered by the priority rules in Article 9, a purchaser for value of a security entitlement or an interest in a security entitlement who obtains control has priority over a purchaser of a security entitlement or an interest in a security entitlement who does not obtain control. Purchasers who have control rank equally, except that a securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

Uniform Comment

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements

from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) [(1)] provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a) [(1)]:

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) [8-1106(4)(b)] by virtue of an agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501 [8-1501]. Under other law, Owner may be able to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) [8-1510(1)] precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) [8-1510(1)] does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) [(2)] applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(33), it did not give value. Thus, Alma Mater is a person who purchased a security entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 [8-1502] rule. Thus, by virtue of Section 8-510(b) [8-1510(2)], Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) [(3)] specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) [(3)] applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 [Article 8-A] and 9.

The following example illustrates subsection (c) [(3)]:

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turns holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities

from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 [8-1502] would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c) [8-1510(3)], RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) [8-1510(1)] which provides that RP1's earlier in time interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section 9-115(5)(a). The main point of the rules of Section 8-510(c) [8-1510(3)] is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default rule of pro rata treatment for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-115(5)(b) and Comment 6 to Section 9-115. Because the purchaser priority rule in Section 8-510(c) [8-1510(3)] is intended to track the Article 9 priority rules, it too has a pro rata rule for cases where multiple non-secured party purchasers have obtained control but omitted to specify their respective rights by agreement.

Definitional Cross References

"Adverse claim"	Section 8-102(a)(1) [8-1102(1)(a)]
"Control"	Section 8-106 [8-1106]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Notice of adverse claim"	Section 8-105 [8-1105]
"Purchase"	Section 1-201(32)
"Purchaser"	Sections 1-201(33) & 8-116 [8-1116]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Value"	Sections 1-201(44) & 8-116 [8-1116]

§8-1511. Priority among security interests and entitlement holders

(1) Except as otherwise provided in subsections (2) and (3), 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.

(2) 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.

(3) 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.

Uniform Comment

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) [(1)] provides that entitlement holders' claims have priority except as otherwise provided in subsection (b) [(2)], and subsection (b) [(2)] provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106 [8-1106]. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to

satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c), but Alpha Bank did not obtain control under Section 8-106 [8-1106]. Thus, under Section 8-511(a) [8-1511(1)] the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 [8-1106] and 9-115. Under Section 8-511(b) [8-1511(2)], Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503 [8-1503], and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) [(2)] the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e) [8-1503(5)], the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the

intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 [Article 8-A] mirrors that requirement, specifying in Section 8-504 [8-1504] that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its customers are protected against loss from a shortfall by the Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 [Article 8-A] is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) [(3)] sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsection (c) [(3)] provides a priority for secured lenders to such clearing corporations. Subsection (c) [(3)] does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References

"Clearing corporation"	Section 8-102(a)(5) [8-1102(1)(e)]
"Control"	Section 8-106 [8-1106]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Security interest"	Section 1-201(37)
"Value"	Sections 1-201(44) & 8-116 [8-1116]

Sec. B-3. Savings. If a security interest in a security is perfected at the date this Part takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this Part, no further action is required to continue perfection. If a security interest in a security is perfected at the date this Part takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this Part, the security interest remains perfected for a period of 4 months after the effective date and continues perfected thereafter if appropriate action to perfect under this Part is taken within that period. If a security interest is perfected at the date this Part takes effect and the security interest can be perfected by filing under this Part, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect.

Uniform Comment

The revision of Article 8 [Article 8-A] should present few significant transition problems. Although the revision involves

significant changes in terminology and analysis, the substantive rules are, in large measure, based upon the current practices and are consistent with results that could be reached, albeit at times with some struggle, by proper interpretation of the rules of present law. Thus, the new rules can be applied, without significant dislocations, to transactions and events that occurred prior to enactment.

The enacting provisions should not, whether by applicability, transition, or savings clause language, attempt to provide that old Article 8 [Article 8-A] continues to apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued before the effective date and that new Article 8 [Article 8-A] applies to those that occur or accrue after the effective date. The reason for revising Article 8 [Article 8-A] and corresponding provisions of Article 9 is the concern that the provisions of old Article 8 [Article 8-A] could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the national system for the clearance and settlement of securities transactions. Accordingly, it is not the case that any effort should be made to preserve the applicability of old Article 8 [Article 8-A] to transactions and events that occurred before the effective date.

Only two circumstances seem to warrant continued application of rules of old Article 8 [Article 8-A]. First, to avoid disruption in the conduct of litigation, it may make sense to provide for continued application of the old Article 8 [Article 8-A] rules to lawsuits pending before the effective date. Second, there are some limited circumstances in which prior law permitted perfection of security interests by methods that are not provided for in the revised version. Section 8-313(1)(h) (1978) permitted perfection of security interests in securities held through intermediaries by notice to the intermediary. Under Revised Articles 8 [Article 8-A] and 9, security interests can be perfected in such cases by control, which requires the agreement of the intermediary, or by filing. It is likely that secured parties who relied strongly on such collateral under prior law did not simply send notices but obtained agreements from the intermediaries that would suffice for control under the new rules. However, it seems appropriate to include a provision that gives a secured creditor some opportunity after the effective date to perfect in this or any other case in which there is doubt whether the method of perfection used under prior law would be sufficient under the new version.

PART C

Sec. C-1. 9-B MRSA §443, sub-§8, as enacted by PL 1987, c. 405, §1, is amended to read:

8. Clearing corporation. Notwithstanding any other provision of law, ~~any fiduciary, as defined in Title 13, section 642, holding securities in its fiduciary capacity,~~ any financial institution or private banker holding securities as a custodian or managing agent, and any financial institution or private banker holding securities as custodian for a fiduciary, are authorized to deposit or arrange for the deposit of such securities in a clearing corporation as defined in Title 11, article ~~8~~ 8-A, upon the following terms and conditions.

A. When those securities are so deposited, certificates representing securities of the same class of the same issuer may be merged and held in bulk in the name of the nominee of the clearing corporation with any other such securities deposited in the clearing corporation by any person, regardless of ownership of the securities, and certificates of small denomination may be merged into one or more certificates of larger denomination. The records of the fiduciary and the records of the financial institution or private banker acting as custodian, as managing agent or as custodian for a fiduciary ~~shall~~ must at all times show the name of the party for whose account the securities are so deposited.

B. Title to the securities may be transferred by bookkeeping entry on the books of the clearing corporation without physical delivery of certificates representing those securities.

C. A financial institution or private banker so depositing securities pursuant to this section ~~shall be~~ is subject to such rules and regulations as, in the case of state-chartered institutions, the superintendent and, in the case of federally chartered institutions, the Federal Home Loan Bank Board or the United States Comptroller of the Currency may from time to time issue.

D. A financial institution acting as custodian for a fiduciary, on demand by the fiduciary, shall certify in writing to the fiduciary the securities so deposited by the financial institution or private banker in the clearing corporation for the account of the fiduciary.

E. A fiduciary, on demand by any party to a judicial proceeding for the settlement of the fiduciary's account or on demand by the attorney for the party, shall certify in writing to the party the securities deposited by the fiduciary in the clearing corporation for its account as the fiduciary.

This subsection ~~shall apply~~ applies to any fiduciary holding securities in its fiduciary capacity and to any financial institution or private banker holding securities as a custodian, managing agent or custodian for a fiduciary, acting on October 3, 1973, or who thereafter may act regardless of the date of the agreement, instrument or court order by which it is appointed and regardless of whether or not the fiduciary, custodian, managing agent or custodian for a fiduciary owns capital stock of the clearing corporation.

Sec. C-2. 11 MRSA §1-105, sub-§(2), as repealed and replaced by PL 1993, c. 349, §26, is amended to read:

(2) When one of the following provisions of this Title specifies the applicable law, that provision governs a contrary agreement only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2-1105 and 2-1106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Governing law in the Article on Funds Transfers. Section 4-1507.

Letters of Credit. Section 5-1116.

Applicability of the Article on Investment Securities. Section ~~8-106~~ 8-1110.

Perfection provisions of the Article on Secured Transactions. Section 9-103.

Sec. C-3. 11 MRSA §1-206, sub-§(2) is amended to read:

(2) Subsection (1) does not apply to contracts for the sale of goods (section 2-201) nor of securities (section ~~8-319~~ 8-1113) nor to security agreements (section 9-203).

Sec. C-4. 11 MRSA §2-512, sub-§(1), ¶(b) is amended to read:

(b) Despite tender of the required documents the circumstances would justify injunction against honor under the provisions of section ~~5-114~~ 5-1109, subsection (2).

Sec. C-5. 11 MRSA §4-104, sub-§(1), ¶(f), as amended by PL 1993, c. 293, Pt. B, §9, is further amended to read:

(f) Documentary draft. "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities as defined in section ~~8-102~~ 8-1102, instructions for uncertificated securities as defined in section ~~8-308~~ 8-1102, or other certificates, statements or the like are to be received by the drawee or other payor before acceptance or payment of the draft.

Sec. C-6. 11 MRSA §5-114, sub-§(2), as amended by PL 1987, c. 625, §2, is further amended to read:

(2) Unless otherwise agreed, when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (section 7-507) or of a certificated security (section ~~8-306~~ 8-1108) or is forged or fraudulent or there is fraud in the transaction~~,~~:

(a) The issuer must honor the draft or demand for payment, if honor is demanded by a negotiating bank or other holder of the draft or demand ~~which~~ that has taken the draft or demand under the credit and under circumstances ~~which~~ that would make it a holder in due course (section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (section 7-502) or a bona fide purchaser of a certificated security (section ~~8-302~~ 8-1302); and

(b) In all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

Sec. C-7. 11 MRSA §9-103, sub-§(1), as reenacted by PL 1977, c. 696, §119, is amended to read:

(1) Documents, instruments, letters of credit and ordinary goods.

(a) This subsection applies to documents ~~and~~, instruments, rights to proceeds of written letters of credit and ~~to~~ goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3) and minerals described in subsection (5).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or nonperfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or nonperfection of the security interest from the time it attaches until 30 days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the 30-day period.

(d) When collateral is brought into and kept in this State while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Part 3 of this Article to perfect the security interest~~,~~:

(i) If the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of 4 months after the collateral is brought into this State, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) If the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;

(iii) For the purpose of priority over a buyer of consumer goods, section 9-307, subsection (3), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

Sec. C-8. 11 MRSA §9-103, sub-§(6), as enacted by PL 1987, c. 625, §5, is repealed.

Sec. C-9. 11 MRSA §9-103, sub-§(7) is enacted to read:

(7) Investment property.

(a) This subsection applies to investment property.

(b) Except as provided in paragraph (f), during the time that a security certificate is located in a jurisdiction, perfection of a security interest, the effect of perfection or nonperfection and the priority of a security interest in the certificated security represented are governed by the local law of that jurisdiction.

(c) Except as otherwise provided in paragraph (f), perfection of a security interest, the effect of perfection or nonperfection and the priority of a security interest in an uncertificated security are governed by the local law of the issuer's jurisdiction as specified in section 8-1110, subsection (4).

(d) Except as otherwise provided in paragraph (f), perfection of a security interest, the effect of perfection or nonperfection and the priority of a security interest in a security entitlement or securities account are governed by the local law of the securities intermediary's jurisdiction as specified in section 8-1110, subsection (5).

(e) Except as otherwise provided in paragraph (f), perfection of a security interest, the effect of perfection or nonperfection and the priority of a security interest in a commodity contract or commodity account are governed by the local law of the commodity intermediary's jurisdiction. The following rules determine a "commodity intermediary's jurisdiction" for purposes of this paragraph.

(i) If an agreement between the commodity intermediary and commodity customer specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(ii) If an agreement between the commodity intermediary and commodity customer does not specify the governing law as provided in subparagraph (i), but expressly specifies that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(iii) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) and (ii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the office identified in an account statement as the office serving the commodity customer's account.

(iv) If an agreement between the commodity intermediary and commodity customer does not specify a jurisdiction as provided in subparagraphs (i) and (ii) and the account statement does not identify an office serving the commodity customer's account as provided in subparagraph (iii), the commodity intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the commodity intermediary.

(f) Perfection of a security interest by filing, automatic perfection of a security interest in investment property granted by a broker or securities intermediary and automatic perfection of a security interest in a commodity contract or commodity account granted by a commodity intermediary are governed by the local law of the jurisdiction in which the debtor is located.

Uniform Comment

The term "at wellhead" is intended to encompass arrangements based on sale of the product as soon as it issues from the ground and is measured, without technical distinctions as to whether title passes at the "Christmas tree" or the far side of a gathering tank or at some other point. The term "at minehead" is a comparable concept.

9. Subsection (6) [(7)] of Section 9-103 specifies choice of law rules for perfection of security interests in investment property. Paragraph (b) covers security interests in certificated securities. Paragraph (c) covers security interests in uncertificated securities. Paragraph (d) covers security interests in security entitlements and securities accounts. Paragraph (e) covers security interests in commodity contracts and commodity accounts. The approach of each of these paragraphs is essentially the same. They identify the jurisdiction's law that governs questions of perfection and priority on the basis of the same principles that are used in Article 8 [Article 8-A] to determine other questions concerning that form of investment property. Thus, for certificated securities, the law of the jurisdiction where the certificate is located governs. Cf.

Section 8-110(c) [8-1110(3)]. For uncertificated securities, the law of the issuer's jurisdiction governs. Cf. Section 8-110(a) [8-1110(1)]. For security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs. Cf. Section 8-110(b) [8-1110(2)]. For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Since commodity contracts and commodity accounts are not governed by Article 8 [Article 8-A], paragraph (e) contains rules that specify the commodity intermediary's jurisdiction. These are analogous to the rules in Section 8-110(e) [8-1110(5)] specifying a securities intermediary's jurisdiction.

Under this subsection, if litigation about perfection or priority arises in this State, the relevant choice of law rule of paragraphs (b) through (e) may point to the law of this State or to the law of another State. If the litigation were in a tribunal of a jurisdiction that has not enacted this section, it would follow its own choice of law rules. The choice of law rules prescribed here by statute conform to generally accepted principles of choice of law. The simplicity and clarity in the choice of law rules, coupled with the explicit recognition that the parties to some securities transactions may agree on a governing law, are intended to assure that there will be one clear choice of law regardless of forum.

Paragraph (f) adapts the general choice of law principles of this subsection to cases where a secured party claims perfection on the basis of filing, or by virtue of the automatic perfection rules in Section 9-115(4)(c) and (d). In such a case, the law of the debtor's jurisdiction determines whether the requirements for that form of perfection have been satisfied. The rules in Section 9-103(3) on the debtor's location ~~can be looked to in applying subsection (f)~~ and effect of change of location apply to cases governed by paragraph (f)*. The main reason for the paragraph (f) rule is to specify the proper filing office. Under the substantive rules of this Act, a security interest in investment property perfected only by filing is enforceable against the debtor or lien creditors, but not against most other claimants. See Sections 9-115(5) and (6), 8-105(e) [8-1105(5)], 8-303 [8-1303], and 8-502 [8-1502]. Because the choice of law rules in this section may, in some circumstances, have the effect of directing a court in a jurisdiction that has adopted this Act to look to the law of another jurisdiction, it is possible that the jurisdiction so specified will be one that has not adopted rules concerning the effect of filing as a method of perfection for investment property. In such cases, or other circumstances where the governing substantive law is not this Act, the effect of filing on the rights of other parties should be interpreted in light of the role of that form of perfection under this Act; that

is, the rights of a secured party in investment property as determined under this Act perfected only by filing against another secured party or any other person who purchases or otherwise deals with the investment property should be interpreted to be no greater than the rights of that secured party under this Act. *Amendments in italics approved by the Permanent Editorial Board for Uniform Commercial Code November 4, 1995.

The following examples illustrate these rules:

Example 1. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a margin loan from Able. Subsection (6)(d) provides that Pennsylvania law -- the law of the securities intermediary's jurisdiction -- governs perfection and priority of the security interest.

Example 2. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer obtains a loan from a lender located in Illinois. The lender takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) [8-1106(4)(b)] to give the lender control. Subsection (6)(d) provides that Pennsylvania law -- the law of the securities intermediary's jurisdiction -- governs perfection and priority of the security interest.

Example 3. A customer residing in New Jersey maintains a securities account with Able & Co. The agreement between the customer and Able specifies that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation, which Able holds through a clearing corporation located in New York. The customer borrows from SP1, and SP1 files a financing statement in New Jersey. Later, the customer obtains a loan from SP2. SP2 takes a security interest and perfects by obtaining an agreement among the debtor, itself, and Able, which satisfies the requirement of Section 8-106(d)(2) [8-1106(4)(b)] to give the SP2 control. Subsection (6)(f) provides that perfection of SP1's security interest by

filing is governed by the location of the debtor, so the filing in New Jersey was appropriate -- assuming New Jersey has adopted the revisions of Article 9 permitting perfection of security interests in investment property by filing. Subsection (6)(d), however, provides that Pennsylvania law -- the law of the securities intermediary's jurisdiction -- governs all other questions of perfection and priority. Thus, Pennsylvania law governs perfection of SP2's security interest, and Pennsylvania law also governs the priority of the security interests of SP1 and SP2.

Sec. C-10. 11 MRSA §9-104, sub-§(12), as enacted by PL 1977, c. 526, §12, is amended to read:

(12) To a transfer of an interest in any deposit account of section 9-105, subsection (1), except as provided with respect to proceeds, section 9-306, and priorities in proceeds, section 9-312~~.~~; or

Sec. C-11. 11 MRSA §9-104, sub-§(14) is enacted to read:

(14) To a transfer of an interest in a letter of credit other than the rights to proceeds of a written letter of credit.

Sec. C-12. 11 MRSA §9-105, sub-§(1), ¶(h), as enacted by PL 1977, c. 696, §124, is amended to read:

(h) Goods. "Goods" includes all things ~~which~~ that are movable at the time the security interests attaches or ~~which~~ are fixtures, section 9-313, but does not include money, documents, instruments, investment property accounts, chattel paper, general intangibles or minerals or the like, including oil and gas, before extraction. "Goods" also includes standing timber ~~which~~ that is to be cut and removed under a conveyance or contract for sale, the unborn young of animals and growing crops.

Sec. C-13. 11 MRSA §9-105, sub-§(1), ¶(i), as amended by PL 1987, c. 625, §7, is further amended to read:

(i) Instrument. "Instrument" means a negotiable instrument, defined in section 3-104, ~~or a certificated security, defined in section 8-102,~~ or any other writing ~~which~~ that evidences a right to the payment of money and is not itself a security agreement or lease and is of a type ~~which~~ that is in ordinary course of business transferred by delivery with any necessary indorsement or assignment. The term does not include investment property;

Sec. C-14. 11 MRSA §9-105, sub-§(2), as amended by PL 1977, c. 696, §125, is further amended to read:

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

"Account."	Section 9-106.
"Attach."	Section 9-203.
"Commodity contract."	Section 9-115.
"Commodity customer."	Section 9-115.
"Commodity intermediary."	Section 9-115.
"Construction mortgage."	Section 9-313, subsection (1).
"Consumer goods."	Section 9-109, subsection (1).
"Control."	Section 9-115.
"Equipment."	Section 9-109, subsection (2).
"Farm products."	Section 9-109, subsection (3).
"Fixture."	Section 9-313.
"Fixture filing."	Section 9-313.
"General intangibles."	Section 9-106.
"Inventory."	Section 9-109, subsection (4).
"Investment property."	Section 9-115.
"Lien creditor."	Section 9-301, subsection (3).
Proceeds."	Section 9-306, subsection (1).
"Purchase money security interest."	Section 9-107.
"United States."	Section 9-103.

Sec. C-15. 11 MRSA §9-105, sub-§(3) is amended to read:

(3) The following definitions in other Articles apply to this Article:

"Broker."	Section 8-1102.
"Certificated security."	Section 8-1102.
"Check."	Section 3-104.
"Clearing corporation."	Section 8-1102.
"Contract for sale."	Section 2-106.
"Control."	Section 8-1106.
"Delivery."	Section 8-1301.
"Entitlement holder."	Section 8-1102.
"Financial asset."	Section 8-1102.
"Holder in due course."	Section 3-302.
"Letter of credit."	Section 5-1102.
"Note."	Section 3-104.

"Proceeds of a letter of credit	Section 5-1114, subsection (1).
"Sale."	Section 2-106.
"Securities intermediary."	Section 8-1102.
"Security."	Section 8-1102.
"Security certificate."	Section 8-1102.
"Security entitlement."	Section 8-1102.
"Uncertificated security."	Section 8-1102.

Uniform Comment

"Instrument": the term as defined in paragraph (1)(i) includes not only negotiable instruments ~~and certificated securities~~ but also any other intangibles evidenced by writings which are in ordinary course of business transferred by delivery. As in the case of chattel paper "delivery" is only the minimum stated and may be accompanied by other steps. Amendment approved by the Permanent Editorial Board for Uniform Commercial Code November 4, 1995.

Sec. C-16. 11 MRSA §9-106, as amended by PL 1977, c. 696, §126, is further amended to read:

§9-106. Definitions: "Account;" "general intangibles"

"Account" means any right to payment for goods sold or leased or for services rendered ~~which~~ that is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. "General intangibles" means any personal property, including things in action, other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

Sec. C-17. 11 MRSA §§9-115 and 9-116 are enacted to read:

§9-115. Investment property

(1) As used in this Article, unless the context otherwise indicates, the following terms have the following meanings.

(a) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is carried for a commodity customer.

(b) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option or other contract that, in each case, is:

(i) Traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to the federal commodities laws; or

(ii) Traded on a foreign commodity board of trade, exchange or market, and is carried on the books of a commodity intermediary for a commodity customer.

(c) "Commodity customer" means a person for whom a commodity intermediary carries a commodity contract on its books.

(d) "Commodity intermediary" means:

(i) A person who is registered as a futures commission merchant under the federal commodities laws; or

(ii) A person who in the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to the federal commodities laws.

(e) "Control" with respect to a certificated security, uncertificated security or security entitlement has the meaning specified in Section 8-1106. A secured party has control over a commodity contract if by agreement among the commodity customer, the commodity intermediary and the secured party, the commodity intermediary has agreed that it will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer. If a commodity customer grants a security interest in a commodity contract to its own commodity intermediary, the commodity intermediary as secured party has control. A secured party has control over a securities account or commodity account if the secured party has control over all security entitlements or commodity contracts carried in the securities account or commodity account.

(f) "Investment property" means:

(i) A security, whether certificated or uncertificated;

(ii) A security entitlement;

(iii) A securities account;

(iv) A commodity contract; or

(v) A commodity account.

(2) Attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. Attachment or perfection of a security interest in a commodity account is also attachment or perfection of a security interest in all commodity contracts carried in the commodity account.

(3) A description of collateral in a security agreement or financing statement is sufficient to create or perfect a security interest in a certificated security, uncertificated security, security entitlement, securities account, commodity contract or commodity account whether it describes the collateral by those terms or as investment property, or by description of the underlying security, financial asset or commodity contract. A description of investment property collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category, by quantity, by a computational or allocational formula or procedure or by any other method, if the identity of the collateral is objectively determinable.

(4) Perfection of a security interest in investment property is governed by the following rules.

(a) A security interest in investment property may be perfected by control.

(b) Except as otherwise provided in paragraphs (c) and (d), a security interest in investment property may be perfected by filing.

(c) If the debtor is a broker or securities intermediary, a security interest in investment property is perfected when it attaches. The filing of a financing statement with respect to a security interest in investment property granted by a broker or securities intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(d) If a debtor is a commodity intermediary, a security interest in a commodity contract or a commodity account is perfected when it attaches. The filing of a financing statement with respect to a security interest in a commodity contract or a commodity account granted by a commodity intermediary has no effect for purposes of perfection or priority with respect to that security interest.

(5) Priority between conflicting security interests in the same investment property is governed by the following rules.

(a) A security interest of a secured party who has control over investment property has priority over a security interest of a secured party who does not have control over the investment property.

(b) Except as otherwise provided in paragraphs (c) and (d), conflicting security interests of secured parties each of whom has control rank equally.

(c) Except as otherwise agreed by the securities intermediary, a security interest in a security entitlement or a securities account granted to the debtor's own securities intermediary has priority over any security interest granted by the debtor to another secured party.

(d) Except as otherwise agreed by the commodity intermediary, a security interest in a commodity contract or a commodity account granted to the debtor's own commodity intermediary has priority over any security interest granted by the debtor to another secured party.

(e) Conflicting security interests granted by a broker, a securities intermediary or a commodity intermediary that are perfected without control rank equally.

(f) In all other cases, priority between conflicting security interests in investment property is governed by section 9-312, subsections (5), (6) and (7). Section 9-312, subsection (4) does not apply to investment property.

(6) If a security certificate in registered form is delivered to a secured party pursuant to agreement, a written security agreement is not required for attachment or enforceability of the security interest, delivery suffices for perfection of the security interest and the security interest has priority over a conflicting security interest perfected by means other than control, even if a necessary indorsement is lacking.

Uniform Comment

1. Overview. This section sets out the principal rules on security interests in investment property. Investment property, defined in subsection (1)(f) is a new term for a category of collateral that includes securities, whether held directly or through intermediaries, and commodity futures. The term investment property is used in Article 9 as one of the general

categories of collateral, such as goods or instruments. Investment property is excluded from the definitions of goods, instruments, and general intangibles. See Sections 9-105(1)(h), 9-105(1)(i), and 9-106.

This section is added as part of the revision of Article 8 [Article 8-A] on investment securities. It relies in part on terms and concepts defined in Revised Article 8 [Article 8-A]. For an overview of Revised Article 8 [Article 8-A], see the Prefatory Note to that Article. Prior to the 1978 amendments to Article 8, the rules on security interests in securities were included in Article 9. The 1978 amendments moved the key rules to Article 8. The revision of Article 8 [Article 8-A] returns these matters to Article 9. In order to avoid disruption of section numbering, the new rules on security interests in investment property are collected in this section, rather than being distributed among the various sections of Article 9 dealing with corresponding issues for other categories of collateral. On matters not covered by rules set out in this section, security interests in investment property are governed by the general rules in other sections of this Article.

The distinction between the direct and indirect holding systems plays an important role in the rules on security interests in securities. Consider two investors, X and Y, each of whom owns 1000 shares of XYZ Co. common stock. X has a certificate representing 1000 shares and is registered on the books maintained by XYZ Co.'s transfer agent as the holder of record of those 1000 shares. X has a direct relationship with the issuer, and receives dividends, distributions, and proxies directly from the issuer. In Revised Article 8 [Article 8-A] terminology, X has a direct claim to a "certificated security." If X wishes to use the investment position as collateral for a loan, X would grant the lender a security interest in the "certificated security." The Article 9 rules for such transactions are explained in Comment 2. XYZ Co. might not issue certificates, but register investors such as X directly on its stockholder books. In that case, X's interest would be an "uncertificated security." The Article 9 rules for uncertificated securities are explained in Comment 3. By contrast to these direct relationships, Y holds the securities through an account with Y's broker. Y does not have a certificate and is not registered on XYZ Co.'s stock books as a holder of record. Rather, Y holds the securities through a chain of securities intermediaries. Under Revised Article 8 [Article 8-A], Y's interest in XYZ common stock is described as a "securities entitlement." If Y wishes to use the investment position as collateral for a loan, Y would grant the lender a security interest in the "securities entitlement." The Article 9 rules for security entitlements are explained in Comment 4.

A commercial setting in which security interests in investment property play a most economically significant role is the "wholesale" level, that is, finance of securities firms and security interests that support the extension of credit in the settlement system. Comments 6 and 7 deal with these transactions. The rules on security interests in investment property also apply to commodity futures. Comment 8 deals with these transactions.

The rules on security interests in investment property are based on the concept of "control," defined in Sections 8-106 [8-1106] and 9-115(1)(e). If the secured party has control the security interest can attach even without a written security agreement. See Section 9-203. A security interest in investment property can also be created by a written security agreement pursuant to Section 9-203. Security interests in investment property can be perfected by control. See subsection (4)(a). Although other methods of perfection are also permitted, the basic priority rule, set out in subsection (5)(a), is that a secured party who obtains control has priority over a secured party who relies on some other method of perfection. The control priority rule is explained in Comment 5.

2. Security interests in certificated securities. A security interest in a certificated security can be created by conferring control on the secured party. Section 8-106 [8-1106] provides that a secured party has control of a certificated security if the certificate has been delivered, see Section 8-301 [8-1301], and any necessary indorsement has been supplied. Section 9-203 provides that a security interest can attach, even without a written security agreement, if the secured party has control. Section 9-115(4)(a) provides that control is a permissible method of perfection.

A security interest in a certificated security can also be created by a written security agreement pursuant to Section 9-203, and can be perfected by filing, see subsection (4)(b). (The perfection by filing rule does not apply if the debtor is a broker or securities intermediary.) However, a security interest perfected only by filing is subordinate to a conflicting security interest perfected by control. See subsection (5)(a) and Comment 5. Also, perfection by filing would not give the secured party protection against other types of adverse claims, since the Article 8 [Article 8-A] adverse claim cut-off rules require control. See Section 8-510 [8-1510].

Section 9-115(6) deals with cases where a secured party has taken possession of an unindorsed security certificate in registered form. It provides that even though the indorsement is

lacking, delivery of the certificate to the secured party suffices for attachment and perfection of the security interest in the certificated security. It also provides that such a possessory security interest has priority over a conflicting non-control security interest, such as a security interest perfected by filing. However, without the indorsement the secured party would not get the other protections against adverse claims that flow from obtaining control. See Section 8-510 [8-1510].

3. Security interests in uncertificated securities. The rules on security interests in uncertificated securities apply only where the debtor is the direct holder of an uncertificated security. For example, mutual funds typically do not issue certificates, but the beneficial owners of mutual funds shares commonly are the direct holders of the shares, whose interests are recorded on the books of the issuer. If such an investor grants a security interest in the mutual funds shares, the rules in this section on security interests in uncertificated securities apply. These rules are not germane to situations where a debtor holds securities through a securities intermediary. Security interests in positions held through securities intermediaries are governed by the rules on security entitlements and securities accounts, not the rules on uncertificated securities.

A security interest in an uncertificated security can be perfected either by control or by filing. See subsection (4)(a) and (b). (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in an uncertificated security are governed by subsection (5). Under subsection (5)(a), a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to uncertificated securities are set out in Section 8-106(c) [8-1106(3)]. There are two possibilities. First, a secured party has control if the uncertificated security is transferred from debtor to secured party on the books of the issuer. See Sections 8-106(c)(1) [8-1106(3)(a)] (control by "delivery") and 8-301(b) [8-1301(2)] (defining "delivery" of uncertificated security). So far as the issuer is concerned, the secured party is the registered owner entitled to all rights of ownership, though as between the debtor and secured party the debtor remains the owner and the secured party holds its interest as secured party. Second, a secured

party has control over an uncertificated security if the issuer agrees that it will comply with "instructions" originated by the secured party without further consent by the registered owner. See Section 8-106(c)(2) [8-1106(3)(b)]. If the debtor, secured party, and issuer agree that the secured party has the right to direct the issuer to dispose of the security without further action by the debtor, the secured party has control even though the debtor remains listed as the registered owner and continues to receive dividends and distributions. Note, though, that there is no statutory requirement that issuers of uncertificated securities offer such arrangements.

4. Security interests in security entitlements and securities accounts. This section establishes a structure for creating security interests in securities and other financial assets that a debtor holds through an account with a securities intermediary. Under Revised Article 8 [Article 8-A], the interest of a person who holds securities through a securities account with a broker or other securities intermediary is described as a security entitlement. Thus, the Article 9 rules governing the use of that person's investment position as collateral are the rules for security entitlements and securities accounts, not the rules for certificated securities or uncertificated securities.

Attachment of security interests in security entitlements and securities accounts is governed by Section 9-203 and subsections (2) and (3) of this section. Unless the secured party has control, a written security agreement is necessary for attachment. For purposes of description of the collateral in a security agreement, it is not essential that the precise Article 8 [Article 8-A] terminology be used. See subsection (3). For example, if a debtor who holds 1000 shares of XYZ Co. common stock through a securities account signs a security agreement which describes the collateral as "1000 shares of XYZ Co. common stock," that description is sufficient, even though the debtor's interest would be described under Revised Article 8 [Article 8-A] as a "security entitlement" to 1000 shares of XYZ Co. common stock.

The Article 8 [Article 8-A] term security entitlement also covers the interest of a person in a "financial asset," if the person holds that financial asset through a securities account. "Financial asset" is a broader term than "security." See Section 8-102(a)(9) [8-1102(1)(i)]. For example, a bankers' acceptance is an Article 3 negotiable instrument and hence an instrument under Section 9-105(1)(i). If a person who holds a bankers' acceptance directly wishes to grant a security interest in it, the Article 9 rules for instruments apply. However, if a person holds a bankers' acceptance through a securities account, the

person has a security entitlement to the bankers' acceptance. If the person wishes to grant a security interest in the security entitlement to the bankers' acceptance, the Article 9 rules for investment property apply.

Subsection (1)(f)(iii) provides that the term investment property also includes "securities account." This is intended to facilitate transactions in which a debtor wishes to grant a security interest in all of the investment positions held through a particular account rather than in particular positions carried in the account. Just as a debtor may grant a security interest either in specifically listed items of equipment or in all of the debtor's equipment, so too a debtor who holds securities or other financial assets through a securities account may grant a security interest either in specifically listed security entitlements or in all of the security entitlements held through that account. Referring to the collateral as the securities account is a simple way of describing all of the security entitlements carried in the account. Section 9-115(2) provides that attachment or perfection of a security interest in a securities account is also attachment or perfection of a security interest in all security entitlements carried in the securities account. A security interest in a securities account would also include all other rights of the debtor against the securities intermediary arising out of the securities account. For example, a security interest in a securities account would include credit balances due to the debtor from the securities intermediary, whether or not they are proceeds of a security entitlement.

A security interest in a security entitlement or securities account can be perfected either by control or by filing. See subsections (4)(a) and (4)(b). (The filing rule does not apply if the debtor is itself a broker or securities intermediary.) Priority disputes among conflicting security interests in a security entitlement or securities account are governed by subsection (5). The basic rule of subsection (5)(a) is that a secured party who obtains control has priority over a secured party who does not have control. Thus, although filing is a permissible method of perfection, a secured party who perfects by filing takes the risk that the debtor has granted or will grant a security interest in the same property to another party who obtains control. See Comment 5.

The requirements for control with respect to security entitlements and securities accounts are set out in Sections 8-106(d) [8-1106(4)] and 9-115(1)(e). There are two possibilities. First, Section 8-106(d)(1) [8-1106(4)(a)] provides that a secured party has control over a security entitlement if the secured party becomes the entitlement holder, that is, the position is transferred from debtor to secured party

on the books of a securities intermediary. See Examples 1 and 2 in Comment 4 to Section 8-106 [8-1106]. Second, Section 8-106(d)(2) [8-1106(4)(b)] provides that a secured party has control over a security entitlement if the securities intermediary agrees that it will comply with entitlement orders originated by the secured party without further consent by the debtor. See Example 3 in Comment 4 to Section 8-106 [8-1106]. If the debtor, secured party, and issuer agree that the secured party has the right to direct the securities intermediary to dispose of the collateral without further action by the debtor, the secured party has control even though the debtor remains listed as the entitlement holder and continues to receive dividends and distributions. The secured party can obtain control even though the debtor is also allowed to continue to trade. See Section 8-106(f) [8-1106(6)] and Comment 7 thereto. The three-party control agreement device is based on arrangements that have already developed in the securities business. Even under prior law, some securities brokers developed standard forms of such agreements. Note though that, as is the case with respect to issuers of uncertificated securities, there is no statutory requirement that securities intermediaries offer such control agreement arrangements.

Subsection (1)(e) provides that a secured party has control over a securities account if it has control over all security entitlements carried in the account. Thus, the rules in Section 8-106(d) [8-1106(4)] on control with respect to security entitlements determine whether a secured party has control over a securities account. Control with respect to a securities account is defined in terms of obtaining control over the security entitlements simply for drafting convenience. Of course, an agreement that provides that the securities intermediary will honor instructions from the secured party concerning a securities account described as such is sufficient since such an agreement necessarily implies that the secured party has control over all security entitlements carried in the account.

If a customer borrows from its own securities intermediary, e.g., to purchase securities "on margin" or for other purposes, and grants a security interest to its intermediary, the intermediary has control. See Section 8-106(e) [8-1106(5)]. A securities firm could also provide control financing arrangements to its customers through a different legal entity than the securities intermediary itself, e.g., the securities trading, custody, and credit services might be provided by different corporate entities within the financial services firm's "family." So long as the agreement with the customer provides that the entity providing the custodial function (the "securities intermediary") will act on instructions received from entity providing the credit, the credit entity has control.

5. Priority Rules. Subsection (5) specifies the priority rules for conflicting security interests in the same investment property. Subsection (5)(a) states the most important general rule -- that a secured party who obtains control has priority over a secured party who does not obtain control. The other priority rules, in subsections (5)(b) through (5)(e), deal with relatively unusual circumstances not covered by the control priority rule. Subsection (5)(f) provides that the general priority rules of Section 9-312 apply to cases not covered by the specific rules in subsection (5). The principal application of this residual rule is that the usual first in time of filing rule applies to conflicting security interests that are perfected only by filing. Because the control priority rule of subsection (5)(a) provides for the ordinary cases in which persons purchase securities on margin credit from their brokers, there is no need for special rules for purchase money security interests. Accordingly, subsection (5)(f) provides that the purchase money priority rule of Section 9-312(4) does not apply to investment property.

The following examples illustrate the basic priority rules of this section:

Example 1. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock for which Debtor has a certificate. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor delivers the certificate, properly indorsed, to Beta. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(b)(1) [8-1106(2)(a)], and hence has priority over Alpha.

Example 2. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor instructs Able to have the 1000 shares transferred through the clearing corporation to Custodian Bank, to be credited to Beta's account with Custodian Bank. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(1) [8-1106(4)(a)], and hence has priority over Alpha.

Example 3. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, which is held through a securities account with Able & Co. Alpha perfects by filing. Later, Debtor borrows from Beta and grants Beta a security interest in the 1000 shares of XYZ Co. stock. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Alpha and Beta both have perfected security interests in the XYZ Co. stock. Beta has control, see Section 8-106(d)(2) [8-1106(4)(b)], and hence has priority over Alpha.

Example 4. Debtor borrows from Alpha and grants Alpha a security interest in a variety of collateral, including all of Debtor's investment property. At that time Debtor owns 1000 shares of XYZ Co. stock, held through a securities account with Able & Co. Alpha perfects by filing. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor incurs obligations to Able and later defaults on the obligations to Alpha and Able. Able has control by virtue of the rule of Section 8-106(e) [8-1106(5)] that if a customer grants a security interest to its own intermediary, the intermediary has control. Since Alpha does not have control, Able has priority over Alpha under the general control priority rule of subsection (5)(a).

Example 5. Debtor holds securities through a securities account with Able & Co. Debtor's agreement with Able & Co. provides that Able has a security interest in all securities carried in the account as security for any obligations of Debtor to Able. Debtor borrows from Beta and grants Beta a security interest in 1000 shares of XYZ Co. stock carried in the account. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions and will continue to have the right to direct dispositions, but Beta will also have the right to direct dispositions and receive the proceeds. Debtor incurs obligations to Able and later defaults on the obligations to Beta and Able. Both Beta and Able have control, so the general control priority rule of subsection (5)(a) does not apply. Compare Example 4. Subsection (5)(c) provides that a security interest held by a securities intermediary in positions of its own customer has priority over a conflicting security interest of an

external lender, so Able has priority over Beta. (Subsection (5)(d) has a parallel rule for commodities intermediaries.) The agreement among Able, Beta, and Debtor could, of course, determine the relative priority of the security interests of Able and Beta, see Section 9-316, but the fact that the intermediary has agreed to act on the instructions of a secured party such as Beta does not itself imply any agreement by the intermediary to subordinate.

The control priority rule does not turn on either temporal sequence or awareness of conflicting security interests. Rather, it is a structural rule, based on the principle that a lender should be able to rely on the collateral without question if the lender has taken the necessary steps to assure itself that it is in a position where it can foreclose on the collateral without further action by the debtor. The control priority rule is necessary because the perfection rules provide considerable flexibility in structuring secured financing arrangements. For example, at the "retail" level, a secured lender to an investor who wants the full measure of protection can obtain control, but the creditor may be willing to accept the greater measure of risk that follows from perfection by filing. Similarly, at the "wholesale" level, a lender to securities firms can leave the collateral with the debtor and obtain a perfected security interest under the automatic perfection rule of subsection (4)(c), but a lender who wants to be entirely sure of its position will want to obtain control. The control priority rule of subsection (5)(a) is an essential part of this system of flexibility. It is feasible to provide more than one method of perfecting secured transactions only if the rules ensure that those who take the necessary steps to obtain the full measure of protection do not run the risk of subordination to those who have not taken such steps. A secured party who is unwilling to run the risk that the debtor has granted or will grant a conflicting control security interest should not make a loan without obtaining control of the collateral.

As applied to the retail level, the control priority rule means that a secured party who obtains control has priority over a conflicting security interest perfected by filing without regard to inquiry into whether the control secured party was aware of the filed security interest. Prior to enactment of this section, Article 9 did not permit perfection of security interests in securities by filing. Accordingly, parties who deal in securities have never developed a practice of searching the UCC files before conducting securities transactions. Although filing is now a permissible method of perfection, in order to avoid disruption of existing practices in this business it is necessary to give perfection by filing a different and more limited effect for securities than for some other forms of

collateral. The priority rules are not based on the assumption that parties who perfect by the usual method of obtaining control will search the files. Quite the contrary, the control priority rule is intended to ensure that secured parties who do obtain control are entirely unaffected by filings. To state the point another way, perfection by filing is intended to affect only general creditors or other secured creditors who rely on filing. The rule that a security interest perfected by filing can be primed by a control security interest, without regard to awareness, is a consequence of the system of perfection and priority rules for investment property. These rules are designed to take account of the circumstances of the securities markets, where filing is not given the same effect as for some other forms of property. No implication is made about the effect of filing with respect to security interests in other forms of property, nor about other Article 9 rules, e.g., Section 9-308, which govern the circumstances in which security interests in other forms of property perfected by filing can be primed by subsequent perfected security interests.

6. Secured finance of securities firms. Modernization of the commercial law rules governing secured finance of securities dealers and security interest arrangements in the clearance and settlement system is essential to the safe and efficient functioning of the securities markets.

Secured financing arrangements for securities firms are currently implemented in various ways. In some circumstances lenders may require that the transactions be structured as "hard pledges," where the securities are transferred on the books of a clearing corporation from the debtor's account to the lender's account or to a special pledge account for the lender where they cannot be disposed of without the specific consent of the lender. In other circumstances, lenders are content with so-called "agreement to pledge" or "agreement to deliver" arrangements, where the debtor retains the positions in its own account, but reflects on its books that the positions have been hypothecated and promises that the securities will be transferred to the secured party's account on demand.

The perfection and priority rules of this section are designed to facilitate current secured financing arrangements for securities firms as well as to provide sufficient flexibility to accommodate new arrangements that develop in the future. Hard pledge arrangements are covered by the concept of control. If the lender obtains control, the security interest is perfected and has priority over a conflicting non-control security interest. For examples of control arrangements in this setting see Examples 4 through 8 in Comment 4 to Section 8-106 [8-1106]. The secured party can obtain control even though the debtor

retains the right to trade or otherwise dispose of the collateral. See Section 8-106(f) [8-1106(6)] and Examples 7 and 8 in Comment 4 to Section 8-106 [8-1106].

Non-control secured financing arrangements for securities firms are covered by the automatic perfection rule of subsection (4)(c). Under prior law, agreement to pledge arrangements could be implemented under a provision that a security interest in securities given for new value under a written security agreement was perfected without filing or possession for a period of 21 days. Although the security interests were temporary in legal theory, the financing arrangements could, in practice, be continued indefinitely by rolling over the loans at least every 21 days. Accordingly, a knowledgeable creditor of a securities firm realizes that the firm's securities may be subject to security interests that are not discoverable from any public records. The perfection rule of subsection (4)(c) makes it unnecessary to engage in the purely formal practice of rolling over these arrangements every 21 days.

Priority questions concerning security interests granted by brokers and securities intermediaries are governed by the general control priority rule of subsection (5)(a), as supplemented by the special rules set out in subsections (b), (c), and (e). In cases not covered by the control priority rule, conflicting security interests rank equally. The following examples illustrate the priority rules as applied to this setting. (In all cases it is assumed that the debtor retains sufficient other securities to satisfy all customers' claims. This section deals with the relative rights of secured lenders to a securities firm. Disputes between a secured lender and the firm's own customers are governed by Section 8-511 [8-1511].)

> Example 6. Able & Co., a securities dealer, enters into financing arrangements with two lenders, Alpha Bank and Beta Bank. In each case the agreements provide that the lender will have a security interest in the securities identified on lists provided to the lender on a daily basis, that the debtor will deliver the securities to the lender on demand, and that the debtor will not list as collateral any securities which the debtor has pledged to any other lender. Upon Able's insolvency it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Alpha and Beta both have perfected security interests under the automatic perfection rule of subsection (4)(c). Neither Alpha nor Beta has control. Subsection (5)(e) provides that the security interests of Alpha and Beta rank equally, because each of them has a non-control security interest granted by a securities firm. They share pro-rata.

> Example 7. Able enters into financing arrangements with Alpha Bank and Beta Bank as in Example 6. At some point, however, Beta decides that it is unwilling to continue to provide financing on a non-control basis. Able directs the clearing corporation where it holds its principal inventory of securities to move specified securities into Beta's account. Upon Able's insolvency it is discovered that a list of collateral provided to Alpha includes securities that had been moved to Beta's account. Both Alpha and Beta have perfected security interests; Alpha under the automatic perfection rule of subsection (4)(c), and Beta under that rule and also the subsection (4)(a) control perfection rule. Beta has control but Alpha does not. Beta has priority over Alpha under subsection (5)(a).

> Example 8. Able & Co. carries its principal inventory of securities through Clearing Corporation, which offers a "shared control" facility whereby a participant securities firm can enter into an arrangement with a lender under which the securities firm will retain the power to trade and otherwise direct dispositions of securities carried in its account, but Clearing Corporation agrees that, at any time the lender so directs, Clearing Corporation will transfer any securities from the firm's account to the lender's account or otherwise dispose of them as directed by the lender. Able enters into financing arrangements with two lenders, Alpha and Beta, each of which obtains such a control agreement from Clearing Corporation. The agreement with each lender provides that Able will designate specific securities as collateral on lists provided to the lender on a daily or other periodic basis, and that it will not pledge the same securities to different lenders. Upon Able's insolvency, it is discovered that Able has listed the same securities on the collateral lists provided to both Alpha and Beta. Both Alpha and Beta have control over the disputed securities. They share pro rata under subsection (5)(b).

7. Secured financing arrangement in the settlement system. Under the rules or agreements governing the relationship between a clearing corporation and its participants, the clearing corporation may have a security interest in securities that the participants have deposited with the clearing corporation pursuant to guaranty fund arrangements or in securities that are in the process of delivery to or from a participant's account in the settlement process. The control rules protect the clearing corporation's rights as secured party in such arrangements, since the clearing corporation would have control over the collateral under the Section 8-106 [8-1106] rules. The control rules also

protect the rights of "upper-tier" intermediaries that are not themselves clearing corporations. For example, if a securities dealer carries its inventory through a clearing bank that provides both custodial and credit services, the clearing bank as secured party would have control and hence be assured of perfection and priority over any potential conflicting security interests granted by the securities dealer.

In some circumstances, a clearing corporation may be the debtor in a secured financing arrangement. For example, a clearing corporation that settles delivery-versus-payment transactions among its participants on a net, same-day basis relies on timely payments from all participants with net obligations due to the system. If a participant that is a net debtor were to default on its payment obligation, the clearing corporation would not receive some of the funds needed to settle with participants that are net creditors to the system. To complete end-of-day settlement after a payment default by a participant, a clearing corporation that settles on a net, same-day basis may need to draw on credit lines and pledge securities of the defaulting participant or other securities pledged by participants in the clearing corporation to secure such drawings. The clearing corporation may be the top tier securities intermediary for the securities pledged, so that it would not be practical for the lender to obtain control. Even where the clearing corporation holds some types of securities through other intermediaries, however, the clearing corporation is unlikely to be able to complete the arrangements necessary to convey "control" over the securities to be pledged in time to complete settlement in a timely manner. However, the term "securities intermediary" is defined in Section 8-102(a)(14) [8-1102(1)(n)] to include clearing corporations. Thus, the perfection rule of subsection (4)(c) applies to security interests in investment property granted by clearing corporations.

In secured financing arrangements for clearing corporations and other securities intermediaries, it is sometimes necessary to specify that a secured lender will have a security interest in a certain bundle of securities that, after all the calculations necessary to complete a processing cycle are completed, turn out to be appropriate and available for pledge. At the time the security interest attaches, the necessary computations may not have been completed, though the information that ultimately will determine what positions are to be pledged has been entered. Accordingly, subsection (3) provides that the description of collateral in a security agreement may identify the collateral by means of a computational or allocational formula.

8. Security interests in commodity futures. Section 9-115 establishes rules on security interests in commodity contracts

and commodity accounts that are, in general, parallel to the rules on security interests in security entitlements and securities accounts. Note, though, that commodity contracts are not "securities" or "financial assets" under Article 8 [Article 8-A]. See Section 8-103(f) [8-1103(6)]. Thus, the relationship between commodity intermediaries and commodity customers is not governed by the indirect holding system rules of Part 5 of Article 8 [Article 8-A]. For securities, the UCC establishes rules in Article 9 on security interests, and rules in Article 8 [Article 8-A] on the rights of transferees, including secured parties, on such matters as the rights of a transferee if the transfer was itself wrongful so that another party has an adverse claim. For commodity contracts, Article 9 establishes rules on security interests, but questions of the sort dealt with in Article 8 [Article 8-A] for securities are left to other law.

Subsection (1) contains the definitions of the terms used in substantive rules on security interests in commodity contracts and commodity accounts. The key term "commodity contract" is defined in subsection (1)(b). Section 8-103(f) [8-1103(6)] provides that a commodity contract, as defined in Section 9-115, is not a security or a financial asset. The result is that the indirect holding system rules in Revised Article 8 [Article 8-A] Part 5 do not apply to anything that falls within the definition of commodity contract in this section. The indirect holding system rules of Article 8 [Article 8-A], however, are intended to be sufficiently flexible that they can be applied to new developments in the securities and financial markets, where that is appropriate. Accordingly, the "commodity contract" definition in this section is narrowly drafted to ensure that it does not operate as an obstacle to the application of the new Article 8 [Article 8-A] indirect holding system rules to new products. The term commodity contract covers those contracts that are traded on or subject to the rules of a designated contract market, and foreign commodity contracts that are carried on the books of American commodity intermediaries. The effect of this definition is that the category of commodity contracts that are excluded from Article 8 [Article 8-A] but governed by Article 9 is essentially the same as the category of contracts that fall within the exclusive regulatory jurisdiction of the federal Commodities Futures Trading Commission.

Commodity contracts are rather different from securities or other financial assets. A person who enters into a commodity futures contract is not buying an asset having a certain value and holding it in anticipation of increase in value. Rather the person is entering into a contract to buy or sell a commodity at set price for delivery at a future time. That contract may become advantageous or disadvantageous as the price of the commodity fluctuates during the term of the contract. The rules

of the commodity exchanges require that the contracts be marked to market on a daily basis, that is the customer pays or receives any increment attributable to that day's price change. Because commodity customers may incur obligations on their contracts, they are required to provide collateral at the outset, known as "original margin," and may be required to provide additional amounts, known as "variation margin," during the term of the contract.

The most likely setting in which a person would want to take a security interest in a commodity contract is where a lender who is advancing funds to finance an inventory of a physical commodity requires the borrower to enter into a commodity contract as a hedge against the risk of decline in the value of the commodity. The lender will want to take a security interest in both the commodity itself and the hedging commodity contract. Typically, such arrangements are structured as security interests in the entire commodity account in which the borrower carries the hedging contracts, rather than in individual contracts. Section 9-115 provides a simple mechanism for implementation of such arrangements, either by granting a security interest in the commodity account, or in particular commodity contracts carried in the account. The security interest can be perfected by filing or by control. Under subsection (1)(e) the secured party can obtain control over a commodity contract or commodity account by obtaining an agreement among the commodity customer, the secured party, and the commodity intermediary in which the commodity intermediary agrees to apply any value distributed as directed by the secured party. This provides a clear and certain legal framework for practices that have already developed in the industry.

One important effect of including commodity contracts and commodity accounts in the new Article 9 rules is to provide a clearer legal structure for the analysis of the rights of commodity clearing organizations against their participants and futures commission merchants against their customers. The rules and agreements of commodity clearing organizations generally provide that the clearing organization has the right to liquidate any participant's positions in order to satisfy obligations of the participant to the clearing corporation. Similarly, agreements between futures commission merchants and their customers generally provide that the futures commission merchant has the right to liquidate a customer's positions in order to satisfy obligations of the customer to the futures commission merchant. Section 9-115 treats these rights as security interests and applies to them the same priority rules that apply to the somewhat analogous relationships between securities clearing corporations or securities intermediaries and their participants or customers. Subsection (1)(e) provides that the

commodity intermediary has control, and therefore the security interest is perfected under subsection (4)(a). Subsection (5)(d) provides that the security interest of a commodity clearing organization in its participant's commodity contracts has priority over any security interest granted by the participant to a third-party lender. Similarly, an FCM's security interest would have priority over any security interest granted by its customer to a third-party lender.

The main property that a commodity intermediary holds as collateral for the obligations that the commodity customer may incur under its commodity contracts is not other commodity contracts carried by the customer but the other property that the customer has posted as margin. Typically, this property will be securities. The commodity intermediary's security interest in such securities is governed by the rules of this section on security interests in securities, not the rules on security interests in commodity contracts or commodity accounts.

Although there are significant analytic and regulatory differences between commodities and securities, the development of commodity contracts on financial products in the past few decades has resulted in a system in which the commodity markets and security markets are closely linked. The Section 9-115 rules on security interests in commodity contracts and commodity accounts provide a structure that may be essential in times of stress in the financial markets. Suppose, for example that a firm has a position in a securities market that is hedged by a position in a commodity market, so that payments that the firm is obligated to make with respect to the securities position will be covered by the receipt of funds from the commodity position. Depending upon the settlement cycles of the different markets, it is possible that the firm could find itself in a position where it is obligated to make the payment with respect to the securities position before it receives the matching funds from the commodity position. If cross-margining arrangements have not been developed between the two markets, the firm may need to borrow funds temporarily to make the earlier payment. The Section 9-115 rules would facilitate the use of positions in one market as collateral for loans needed to cover obligations in the other market.

9. Relation to other law. Section 1-103 provides that "unless displaced by particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." There may be circumstances in which a secured party's action in acquiring a security interest that has priority under this section constitutes conduct that is wrongful under other law. Though the possibility of such resort to other law may provide an appropriate "escape valve" for cases of egregious

conduct, care must be taken to ensure that this does not impair the certainty and predictability of the priority rules. Whether a court may appropriately look to other law to impose liability upon or estop a party from asserting its Article 9 priority depends on an assessment of the party's conduct under the standards established by such other law as well as a determination of whether the particular application of such other law is displaced by the UCC.

Some circumstances in which other law is clearly displaced by the UCC rules are readily identifiable. Common law "first in time, first in right" principles, or correlative tort liability rules such as common law conversion principles under which a purchaser may incur liability to a party with a prior property interest without regard to awareness of that claim, are necessarily displaced by the priority rules set out in this section since these rules determine the relative ranking of security interests in investment property. So too, Article 8 [Article 8-A] provides protections against adverse claims to certain purchasers of interests in investment property. In circumstances where a secured party not only has priority under Section 9-115, but also qualifies for protection against adverse claims under Section 8-303 [8-1303], 8-502 [8-1502], or 8-510 [8-1510], resort to other law would be precluded.

In determining whether it is appropriate in a particular case to look to other law, account must also be taken of the policies that underlie the commercial law rules on securities markets and security interests in securities. A principal objective of the revision of Article 8 [Article 8-A] and corresponding provisions of Article 9 is to ensure that secured financing transactions can be implemented on a simple, timely, and certain basis. One of the circumstances that led to the revision was the concern that uncertainty in the application of the rules on secured transactions involving securities and other financial assets could contribute to systemic risk by impairing the ability of financial institutions to provide liquidity to the markets in times of stress. The control priority rule is designed to provide a clear and certain rule to ensure that lenders who have taken the necessary steps to establish control do not face a risk of subordination to other lenders who have not done so.

The control priority rule does not turn on an inquiry into the state of a party's awareness of potential conflicting claims because a rule under which a party's rights depended on that sort of after the fact inquiry could introduce an unacceptable measure of uncertainty. If an inquiry into awareness could provide a complete and satisfactory resolution of the problem in all cases, the priority rule of this section would have incorporated that

test. The fact that it does not necessarily means that resort to other law based solely on that factor is precluded, though the question whether a control secured party induced or encouraged its financing arrangement with actual knowledge that the debtor would be violating the rights of another secured party may, in some circumstances, appropriately be treated as a factor in determining whether the control party's action is the kind of egregious conduct for which resort to other law is appropriate.

Definitional Cross References:

"Broker"	Section 8-102(a)(3) [8-1102(1)(c)]
"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Collateral"	Section 9-105(1)(c)
"Control"	Section 8-106 [8-1106]
"Debtor"	Section 9-105(1)(d)
"Delivery"	Section 8-301 [8-1301]
"Entitlement holder"	Section 8-102(a)(7) [8-1102(1)(g)]
"Secured party"	Section 9-105(1)(m)
"Securities account"	Section 8-501 [8-1501]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security"	Section 8-102(a)(15) [8-1102(1)(o)]
"Security agreement"	Section 9-105(1)(1)
"Security certificate"	Section 8-102(a)(16) [8-1102(1)(p)]
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Security interest"	Section 1-201(37)
"Uncertificated security"	Section 8-102(a)(18) [8-1102(1)(r)]

§9-116. Security interest arising in purchase or delivery of financial asset

(1) If a person buys a financial asset through a securities intermediary in a transaction in which the buyer is obligated to pay the purchase price to the securities intermediary at the time of the purchase, and the securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary, the securities intermediary has a security interest in the buyer's security entitlement securing the buyer's obligation to pay. A security agreement is not required for attachment or enforceability of the security interest and the security interest is automatically perfected.

(2) If a certificated security, or other financial asset represented by a writing that in the ordinary course of business is transferred by delivery with any necessary indorsement or assignment is delivered pursuant to an agreement between persons in the business of dealing with such securities or financial assets and the agreement calls for delivery versus payment, the person delivering the certificate or other financial asset has a

security interest in the certificated security or other financial asset securing the seller's right to receive payment. A security agreement is not required for attachment or enforceability of the security interest, and the security interest is automatically perfected.

Uniform Comment

1. This section establishes two special rules concerning security interests in investment property in order to provide certainty in the securities settlement system.

2. Depending upon a securities intermediary's arrangements with its entitlement holders, the securities intermediary may treat the entitlement holder as entitled to the securities in question before the entitlement holder has actually made payment for them. For example, many brokers permit retail customers to pay for securities by check. The broker may not receive final payment of the check until several days after the broker has credited the customer's securities account for the securities. Thus, the customer will have acquired a security entitlement prior to payment. Subsection (1) provides that in such circumstances the securities intermediary has a security interest in the entitlement holder's security entitlement as security for the payment obligation. This is a codification and adaptation to the indirect holding system of the so-called "broker's lien," which has long been recognized in existing law. See Restatement of Security § 12. An intermediary who has a security interest under this section will have control by virtue of Section 8-106(e) [8-1106(5)]. The security interest has priority over conflicting security interests granted by the entitlement holder, under Section 9-115(5)(a) and (c).

3. Subsection (2) specifies the rights of persons who deliver certificated securities or other financial assets in physical form, such as money market instruments, if the agreed payment is not received. In the typical arrangement for settlement of physical securities, the seller's securities custodian will deliver the physical certificates to the buyer's securities custodian and receive a time-stamped delivery receipt. The buyer's securities custodian will examine the certificate to ensure that it is in good order, and that the delivery matches a trade in which the buyer has instructed the seller to deliver to that custodian. If all is in order, the receiving custodian will settle with the delivering custodian through whatever funds settlement system has been agreed upon or is used by custom and usage in that market. The understanding of the trade, however, is that the delivery is conditioned upon payment, so that if payment is not made for any reason, the security will be returned to the deliverer. Subsection (2) is

intended to clarify the rights of persons making deliveries in such circumstances. It specifies that the person making delivery has a security interest in the securities or other financial assets, securing the right to receive payment. No security agreement is required for attachment, and no filing or other action is required for perfection.

Definitional Cross References:

"Certificated security"	Section 8-102(a)(4) [8-1102(1)(d)]
"Financial asset"	Section 8-102(a)(9) [8-1102(1)(i)]
"Securities account"	Section 8-501 [8-1501]
"Securities intermediary"	Section 8-102(a)(14) [8-1102(1)(n)]
"Security agreement"	Section 9-105(1)(l)
"Security entitlement"	Section 8-102(a)(17) [8-1102(1)(q)]
"Security interest"	Section 1-201(37)

Sec. C-18. 11 MRSA §9-203, sub-§(1), as amended by PL 1987, c. 625, §8, is further amended to read:

(1) Subject to the provisions of section 4-208 on the security interest of a collecting bank, ~~section 8-321 on security interests in securities and~~ section 9-113 on a security interest arising under the Article on sales and sections 9-115 and 9-116 on security interests in investment property, a security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) The collateral is in the possession of the secured party pursuant to agreement, the collateral is investment property and the secured party has control pursuant to agreement or the debtor has signed a security agreement ~~which~~ that contains a description of the collateral and in addition, when the security interest covers crops growing or to be grown or timber to be cut, a description of the land concerned; and

(b) Value has been given; and

(c) The debtor has rights in the collateral.

Sec. C-19. 11 MRSA §9-301, sub-§(1), ¶(d), as amended by PL 1977, c. 526, §34, is further amended to read:

(d) In the case of accounts and, general intangibles and investment property, a person who is not a secured party and who is a transferee to the extent that ~~he~~ the person gives value without knowledge of the security interest and before it is perfected.

Sec. C-20. 11 MRSA §9-302, sub-§(1), ¶(b) is amended to read:

(b) A security interest temporarily perfected in instruments, certificated securities or documents without delivery under section 9-304 or in proceeds for a 10-day period under section 9-306;

Sec. C-21. 11 MRSA §9-302, sub-§(1), ¶(d), as amended by PL 1993, c. 41, §1, is further amended to read:

(d) A purchase money security interest in consumer goods where the amount financed, as defined in Title 9-A, section 1-301, subsection 5, is less than $2,000, but fixture filing is required for priority over conflicting interests in fixtures to the extent provided in section 9-313~~,~~;

Sec. C-22. 11 MRSA §9-302, sub-§(1), ¶(f), as amended by PL 1987, c. 625, §9, is further amended to read:

(f) A security interest of a collecting bank, section 4-208~~, or in securities (section 8-321)~~ or arising under the Article on sales, see section 9-113, or covered in subsection (3)~~,~~;

Sec. C-23. 11 MRSA §9-302, sub-§(1), ¶(g), as repealed and replaced by PL 1977, c. 696, §130, is amended to read:

(g) An assignment for the benefit of all the creditors of the transferor, and subsequent transfers by the assignee thereunder~~,~~; or

Sec. C-24. 11 MRSA §9-302, sub-§(1), ¶(h) is enacted to read:

(h) A security interest in investment property that is perfected without filing under section 9-115 or 9-116.

Sec. C-25. 11 MRSA §9-303, sub-§(1), is amended to read:

(1) A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in sections 9-115, 9-302, 9-304, 9-305 and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

Sec. C-26. 11 MRSA §9-304, as amended by PL 1987, c. 625, §§10 to 12, is further amended to read:

§9-304. Perfection of security interest in instruments, documents, proceeds of a written letter of credit and goods covered by documents; perfection by permissive filing; temporary perfection without filing or transfer of possession

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party's taking possession of the letter of credit. A security interest in money or instruments (other than ~~certificated securities or~~ instruments ~~which~~ that constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) and section 9-306, subsections (2) and (3) on proceeds.

(2) During the period that goods are in the possession of the issuer of a negotiable document therefor, a security interest in goods is perfected by perfecting a security interest in the document, and any security interest in the goods otherwise perfected during such period is subject thereto.

(3) A security interest in goods in the possession of a bailee other than one who has issued a negotiable document therefor is perfected by issuance of a document in the name of the secured party or by the bailee's receipt of notification of the secured party's interest or by filing as to the goods.

(4) A security interest in instruments, ~~other than~~ certificated securities, or negotiable documents is perfected without filing or the taking of possession for a period of 21 days from the time it attaches to the extent that it arises for new value given under a written security agreement.

(5) A security interest remains perfected for a period of 21 days without filing where a secured party having a perfected security interest in an instrument, ~~other than~~ a certificated security, a negotiable document or goods in possession of a bailee other than one who has issued a negotiable document therefor;

(a) Makes available to the debtor the goods or documents representing the goods for the purpose of ultimate sale or exchange or for the purpose of loading, unloading, storing, shipping, transshipping, manufacturing, processing or otherwise dealing with them in a manner preliminary to their sale or exchange but priority between conflicting security interests in the goods is subject to section 9-312, subsection (3); or

(b) Delivers the instrument to the debtor for the purpose of ultimate sale or exchange or of presentation, collection, renewal or registration of transfer.

(6) After the 21-day period in subsections (4) and (5), perfection depends upon compliance with applicable provisions of this Article.

Sec. C-27. 11 MRSA §9-305, as amended by PL 1987, c. 625, §13, is further amended to read:

§9-305. When possession by secured party perfects security interest without filing

A security interest in ~~letters of credit and advices of credit (section 5-116, subsection (2), paragraph (a))~~, goods, instruments, ~~other than certificated securities~~, money, negotiable documents or chattel paper may be perfected by the secured party's taking possession of the collateral. A security interest in the right to proceeds of a written letter of credit may be perfected by the secured party's taking possession of the letter of credit. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

Uniform Comment

1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare Section 9-302(1)(a). This section permits a security interest to be perfected by transfer of possession only when the collateral is goods, rights to proceeds of letters of credit (if written), instruments ~~(other than certificated securities, which are governed by Section 8-321)~~*, documents or chattel paper: that is to say, accounts and general intangibles are excluded. As to perfection of security interests in certificated securities by possession, see the general rules on perfection of security interests in investment property in Section 9-115(4) and the special rule in Section 9-115(6) dealing with cases where a secured party takes possession of a security certificate in registered form without obtaining an indorsement.* ~~See Section 5-116 for the special case of assignments of letters and advices of credit.~~ A security interest in accounts and general intangibles - property not ordinarily represented by any writing whose delivery operates to transfer the claim - may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a "pledge". Section 9-302(1)(e) exempts from filing certain assignments of accounts which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under Section 9-303(1); they do not fall within this section. *Amendments approved by the Permanent Editorial Board for Uniform Commercial Code November 4, 1995.

Sec. C-28. 11 MRSA §9-306, sub-§(1) is amended to read:

(1) "Proceeds" includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds. Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement. Any payments or distributions made with respect to investment property collateral are proceeds. Money, checks, deposit accounts and the like are "cash proceeds." All other proceeds are "noncash proceeds."

Sec. C-29. 11 MRSA §9-306, sub-§(3), ¶(c), as repealed and replaced by PL 1977, c. 696, §134, is amended to read:

(c) The security interest in the proceeds is perfected before the expiration of the 10-day period.; or

Sec. C-30. 11 MRSA §9-306, sub-§(3), ¶(d) is enacted to read:

(d) The original collateral was investment property and the proceeds are identifiable cash proceeds.

Sec. C-31. 11 MRSA §9-309, as amended by PL 1987, c. 625, §16, is further amended to read:

§9-309. Protection of purchasers of instruments, documents and securities

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (section 3-302) or a holder to whom a negotiable document of title has been duly negotiated (section 7-501) or a ~~bona fide~~ protected purchaser of a security (section ~~8-302~~ 8-1303) and such holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

Sec. C-32. 11 MRSA §9-312, sub-§(1), as amended by PL 1977, c. 696, §135, is further amended to read:

(1) The rules of priority stated in other sections of this Part and in the following sections ~~shall~~ govern when applicable: Section 4-~~208~~ 4-210 with respect to the security interests of collecting banks in items being collected, accompanying documents and proceeds; section 9-103 on security interests related to other jurisdictions; ~~and~~ section 9-114 on consignments; and section 9-115 on security interests in investment property.

Sec. C-33. 11 MRSA §9-312, sub-§(7), as amended by PL 1987, c. 625, §17, is further amended to read:

(7) If future advances are made while a security interest is perfected by filing, by the taking of possession, or under section ~~8-321--on--securities~~ 9-115 or 9-116 on investment property, the security interest has the same priority for the purposes of subsection (5) or section 9-115, subsection (5) with respect to the future advances as it does with respect to the first advance. If a commitment is made before or while the security interest is so perfected, the security interest has the same priority with respect to advances made pursuant thereto. In other cases, a perfected security interest has priority from the date the advance is made.

Sec. C-34. 13 MRSA c. 21, as amended, is repealed.

Uniform Comment

If the State has adopted the Uniform Act for the Simplification of Fiduciary Security Transfers, or similar legislation, it should be repealed.

Sec. C-35. 13-A MRSA §616, sub-§3, as enacted by PL 1971, c. 439, §1, is amended to read:

3. Unless noted on the face or back of the share certificates representing such shares, a restriction on transfer imposed either by agreement under subsection 1 or by the articles or bylaws under subsection 2 ~~shall--be~~ is ineffective, except against a person who had actual knowledge of it at the time he the person acquired the shares. This subsection ~~shall--be~~ is construed in the light of Title 11, section 8-~~204~~ 8-1204 and the statutory definitions applicable thereto.

Sec. C-36. 30-A MRSA §5706, sub-§2, as amended by PL 1995, c. 664, §2, is further amended to read:

2. Repurchase agreements. In repurchase agreements secured by obligations of the United States Government, as defined in section 5712, subsection 1, as long as the market value of the underlying obligation is equal to or greater than the amount of the municipality's investment and the municipality's security interest is perfected pursuant to the provisions of Title 11, sections ~~8-313-and-8-321~~ 8-1102, 8-1111, 8-1301, 8-1501, 8-1503, 9-115 and 9-203, except that, if the term of the repurchase agreement is not in excess of 96 hours, the municipality's interest in the underlying security need not be perfected as long as an executed Public Securities Association form of master repurchase agreement is on file with the counterparty prior to the date of the transaction;

PART D

Sec. D-1. Legislative intent. This Act is the Maine enactment of the Uniform Commercial Code, Articles 5 and 8 as revised by the National Conference of Commissioners on Uniform State Laws. The text of that uniform Act has been changed to conform to Maine statutory conventions and the Articles are enacted as Articles 5-A and 8-A. The changes are technical in nature and it is the intent of the Legislature that this Act be interpreted as substantively the same as the revised Articles 5 and 8 of the uniform Act.

SUMMARY

This bill enacts changes recommended by the National Conference of Commissioners on Uniform State Laws as revisions to the Uniform Commercial Code, Article 5, on letters of credit and Article 8, on investment securities. Part A of this bill repeals the Maine Revised Statutes, Title 11, Article 5 and enacts a new Title 11, Article 5-A to accomplish those revisions. Part B of this bill repeals Title 11, Article 8 and enacts a new Title 11, Article 8-A to accomplish those revisions. Part C of this bill makes necessary conforming amendments and recommended changes to various provisions of law to provide consistency with the new Articles 5-A and 8-A.

Part D provides that the text of the Uniform Act has been changed to conform to Maine statutory conventions, the changes are technical in nature and it is the intent of the Legislature that this Act be interpreted as substantially the same as the revised Articles 5 and 8 of the Uniform Act.